



Mitchell Hamline School of Law
Mitchell Hamline Open Access

Faculty Scholarship

2009

Finessing Well-Plead Derivative Lawsuits: The Implications of the Minnesota Supreme Court's Selection of Auerbach over Zapata

James F. Hogg

William Mitchell College of Law, james.hogg@wmitchell.edu

Publication Information

36 William Mitchell Law Review 70 (2009)

Repository Citation

Hogg, James F., "Finessing Well-Plead Derivative Lawsuits: The Implications of the Minnesota Supreme Court's Selection of Auerbach over Zapata" (2009). *Faculty Scholarship*. Paper 164.
<http://open.mitchellhamline.edu/facsch/164>

This Article is brought to you for free and open access by Mitchell Hamline Open Access. It has been accepted for inclusion in Faculty Scholarship by an authorized administrator of Mitchell Hamline Open Access. For more information, please contact sean.felhofer@mitchellhamline.edu.



mitchellhamline.edu

Finessing Well-Plead Derivative Lawsuits: The Implications of the Minnesota Supreme Court's Selection of Auerbach over Zapata

Abstract

This article begins with the factual background and subsequent procedural history of the UnitedHealth Group Inc. shareholder derivative litigation, as an instance where Minnesota courts effectively disposed of the factual allegations in a well-pleaded derivative action, directed at the behavior and actions of members of a board of directors, without reviewing finding of facts or reasoning behind the SLC's report or conclusions. The purpose of this article is to understand how a board-appointed committee can convince a court to dismiss and settle a derivative suit without showing detailed justification, and this is achieved by reviewing the statutes, case law, and theoretical concepts behind derivative suits. Thus, this article first focuses on the current framework under Minnesota law governing corporate directors' duties and responsibilities, the business judgment rule, and the shareholders' opportunity to bring derivative suits. Then, this article analyzes how these matters are handled by SLCs. In the fourth section, the story finally reaches the derivative suit against UHG, where the reader will see how it was dismissed and settled with minimal judicial review. The fifth part analyzes the standard the Minnesota Supreme Court adopted for reviewing SLC decisions to dismiss and settle derivative suits. The sixth and final portion assesses the scope of continuing director accountability in Minnesota.

Keywords

UnitedHealth Group, Inc., UHG, derivative lawsuits, well-pleaded action, accountability, board of directors liability, Special Litigation Committee, settle derivative suit, dismiss derivative suit, Minn. Stat. 302A.201, fiduciary duty, good faith, best interest

Disciplines

Business Organizations Law

Comments

This article is co-authored by Kyle R. Triggs.

FINESSING WELL-PLEAD DERIVATIVE LAWSUITS: THE IMPLICATIONS OF THE MINNESOTA SUPREME COURT'S SELECTION OF *AUERBACH* OVER *ZAPATA*

James F. Hogg[†] and Kyle R. Triggs^{††}

I. INTRODUCTION.....	71
II. THE CURRENT CORPORATE LIABILITY FRAMEWORK IN MINNESOTA.....	74
A. <i>Directors' Duties and Liabilities</i>	74
B. <i>Indemnification: Smith v. VanGorkom's Effect on Director's Accountability</i>	75
C. <i>Shareholders' Remedies: The Derivative Suit</i>	79
1. <i>The Basics: How It Differs from Class Actions and How It Was Used in UnitedHealth.</i>	79
2. <i>The Stages of the Derivative Suit</i>	80
III. SLCs.....	83
A. <i>Auerbach and Zapata: Minnesota's Starting Point for Reviewing SLCs.</i>	83
B. <i>How the Conflict Between Auerbach and Zapata Influenced Minnesota Case Law Before UnitedHealth</i>	85
IV. IN RE <i>UNITEDHEALTH GROUP INC.</i> SHAREHOLDER DERIVATIVE LITIGATION	89
A. <i>Facts and Procedure</i>	89
B. <i>Judge Rosenbaum's Misgivings</i>	94
C. <i>The Minnesota Supreme Court's Decision and Underlying Analysis</i>	95
1. <i>The Court's Quest for Statutory Guidance</i>	96
2. <i>Seeking Help from Case Law</i>	97
D. <i>Justice Anderson's Concurrence: The Idea of a Rationality</i>	

[†] Professor of Law, William Mitchell College of Law; LL.M., 1954; S.J.D., 1959, Harvard Law School; B.A., 1949; LL.B., 1951; LL.M., 1952, University of New Zealand.

^{††} J.D. Candidate, 2010, William Mitchell College of Law; B.A., 2007, Political Science, Saint John's University. The authors wish to thank Lisa Damhof and the William Mitchell Law Review Assistant Editors and Staff Members for their work and contributions towards this article.

<i>Standard</i>	98
V. ANALYSIS OF THE <i>UNITEDHEALTH</i> DECISION	99
A. <i>Statutory Support for a More Enhanced Review</i>	101
B. <i>Structural Bias and the Problems with Tainted Boards</i>	
<i>Selecting the SLCs</i>	103
1. <i>In-Group Bias</i>	104
2. <i>Cultural Bias</i>	105
3. <i>The UnitedHealth Standard Underestimates</i>	
<i>Structural Bias</i>	107
C. <i>Difficulties in Confirming Good Faith and Adequacy</i>	108
VI. DEBATABLE CRITICISM: A BETTER UNDERSTANDING OF	
THE <i>ZAPATA</i> STANDARD	108
VII. CONCLUSION	112

I. INTRODUCTION

Over the past several years, corporate failures of all sorts have flooded this country. Because directors are supposed to manage the affairs of the corporation, to what extent are they responsible for these failures? If corporate disasters result from ineffective management by boards of directors, when might members of a board bear personal liability for losses caused to shareholders and the company? Although directors must have played substantial roles in these catastrophes, they have faced relatively little finger-pointing. Do boards of directors have any significant accountability anymore for how they manage a corporation?

A case in point is the local, but nationally very large, UnitedHealth Group, Inc. (UHG). Backdated stock options were allegedly granted to UHG's former chief executive officer, former general counsel, and its many other officers and employees.¹ Thus, the following lawsuits were brought against these parties and, in some cases, the company itself. The Securities and Exchange Commission brought civil actions against the CEO, the general counsel, and UHG.² A class action suit for violation of the federal

1. Charles Forelle & James Bandler, *The Perfect Payday*, WALL ST. J., Mar. 18, 2006, at A1 (reporting options granted to members of the board of directors were apparently not backdated).

2. Complaint, Sec. & Exch. Comm'n v. McGuire, (No. 06CV01216), 631 F. Supp. 2d 1151 (D. Minn. Dec. 7, 2007), 2007 WL 4298731 [hereinafter SEC Complaint].

securities laws was brought in federal district court.³ A derivative action was brought in federal district court⁴ and another derivative action was brought in Minnesota state court.⁵

The CEO and general counsel faced injunctions and severe penalties imposed by the SEC, and while UHG neither admitted nor denied the SEC's allegations, the court enjoined the company from further specified violations of the federal securities laws.⁶ Pursuant to a preliminarily approved settlement of the class action suit, UHG paid \$895 million into a settlement fund for the benefit of class members given the alleged federal securities law violations.⁷ Recently, the state and federal plaintiffs' counsel sought a combined attorneys' fee award of \$64 million, which UHG contested.⁸

A proposed settlement of both federal and state derivative suits was reached by a special litigation committee (SLC) with the former CEO, the former general counsel, and a former member of the board.⁹ Subject to the individual settlement agreements, the

3. Consolidated Complaint, *In re UnitedHealth Group, Inc.* PSLRA Litig., No. 0:06-cv-01691-JMR-FLN, Fed. Sec. L. Rep. P 94344 (D. Minn. Dec. 8, 2006), 2006 WL 3716007 [hereinafter Class Action Complaint], (referring to 17 C.F.R. § 240.10(b)(5) (2006)); see also STANFORD LAW SCHOOL IN COOPERATION WITH CORNERSTONE RESEARCH, SECURITIES ACTION CLEARINGHOUSE, COMPANY AND CASE INFORMATION, UNITEDHEALTH GROUP, INC., available at http://securities.stanford.edu/1036/UNH_01/ [hereinafter STANFORD REPORT].

4. See, e.g., Lead Plaintiffs' Amended and Consolidated Verified Derivative and Class Action Complaint, *In re UnitedHealth Group, Inc.* S'holder Derivative Litig., No. 06-1216 JMR/FLN, 631 F. Supp. 2d 1151 (D. Minn. Sept. 21, 2006), 2006 WL 2791649 [hereinafter Amended Consolidated Derivative and Class Action Complaint].

5. Consolidated Derivative Complaint, *In re UnitedHealth Group, Inc.* Derivative Litig., No. 27-CV-06-8085 (Minn. 4th Dist. Ct. Aug. 14, 2005), available at <http://www.gardylaw.com/docs/155-Complaint%208-14-06.pdf> [hereinafter State Consolidated Derivative Complaint].

6. *In re UnitedHealth Group, Inc.* S'holder Derivative Litig., No. 06-CV-1216 JMR/FLN, 06-CV-1691 JMR/FLN, 2007 WL 4571127 (D. Minn. Dec. 26, 2007) (noting that the civil fine was the "largest ever assessed by the SEC"); *In re UnitedHealth Group, Inc.* S'holder Derivative Litig., 754 N.W.2d 544, 548 (Minn. 2008).

7. STANFORD REPORT, *supra* note 3.

8. See Defendants' Memorandum of Law in Opposition to Lead Plaintiffs' Counsel's Fee Applications, *In re UnitedHealth Group Inc.* S'holder Derivative Litig., Nos. 06-1216 (JMR/FLN), 27 CV 06-8085, 631 F. Supp. 2d 1151 (D. Minn. Feb. 4, 2009), 2009 WL 319525.

9. See Report of the Special Litigation Committee ¶ 4, Sec. & Exch. Comm'n v. McGuire, No. 06CV01216, 631 F. Supp. 2d 1151 (D. Minn. Dec. 6, 2007), 2007 WL 4298730 [hereinafter SLC Report] (the former member of the board, coincidentally, was also former chairman of the compensation committee).

SLC recommended that all claims against all named defendants in the derivative actions, including current and former UHG officers and directors, should be dismissed.¹⁰ The proposed settlement agreements received approval by both the state and federal courts.¹¹ Although these suits have been settled or remain subject to approved settlements, no member of the board of directors, other than the former CEO and former general counsel, has apparently been found liable.¹²

The shareholders filed well-pleaded complaints in both the federal and state derivative actions. Furthermore, they filed a well-pleaded and subsequently class-action-certified complaint, alleging that the defendants violated federal securities laws. The defendants even paid \$895 million to settle that complaint.¹³ Despite these facts, there has been no adjudication in a court of law of the UHG board's responsibility or accountability. The appointment and report of the SLC finessed any such adjudication *without showing any findings of fact and reasons supporting its conclusions*.¹⁴ And so, Minnesota courts effectively disposed of the factual allegations in these well-pleaded derivative actions, directed at the behavior and actions of certain members of the board, without reviewing findings of fact or reasoning behind the SLC's conclusions. How could this happen? The story is long, complicated, and intriguing.

To understand how a board-appointed committee can convince a court to dismiss and settle a derivative suit without showing *detailed* justification, it is appropriate to review the statutes, case law, and theoretical concepts behind derivative suits. Thus, this article first focuses on the current framework under Minnesota law governing corporate directors' duties and responsibilities,¹⁵ the business judgment rule,¹⁶ and the shareholders' opportunity to

10. *Id.*

11. *In re UnitedHealth Group, Inc. S'holder Derivative Litig.*, 631 F. Supp. 2d 1151, 1151 (D. Minn. 2009); *In re UnitedHealth Group, Inc. S'holder Derivative Litig.*, No. 27-CV-06-8085 (Minn. 4th Dist. Ct. May 14, 2009), *available at* http://www.mncourts.gov/Documents/4/Public/News/Orders/UnitedHealth_Group_Incorporated_5-14-09.pdf.

12. See SLC Report, *supra* note 9, ¶ IV.

13. UnitedHealth Group, Inc., Quarterly Report (Form 10Q), at 22 (May 7, 2009) [hereinafter 10Q Report], *available at* http://www.unitedhealthgroup.com/invest/2009/UHG_Q1_2009_10-Q_FINAL.pdf.

14. See SLC Report, *supra* note 9.

15. See *infra* Part II.

16. See *infra* Part II.A.

bring derivative suits.¹⁷ Then, this article analyzes how these matters are handled by SLCs.¹⁸ In the fourth section, the story finally reaches the derivative suit against UHG, where the reader will see how it was dismissed and settled with minimal judicial review.¹⁹ The fifth part analyzes the standard the Minnesota Supreme Court adopted for reviewing SLC decisions to dismiss and settle derivative suits.²⁰ The sixth and final portion assesses the scope of continuing director accountability in Minnesota.²¹

II. THE CURRENT CORPORATE LIABILITY FRAMEWORK IN MINNESOTA

A. *Directors' Duties and Liabilities*

Our story begins with Minnesota Statutes section 302A.201, which provides that Minnesota corporations shall be managed “by or under the direction of a board.”²² Section 302A.251 continues and defines the fiduciary duties of directors: “[a] director shall discharge the duties of the position of director in good faith, in a manner the director reasonably believes to be in the best interests of the corporation, and with the care an ordinarily prudent person in a like position would exercise under similar circumstances.”²³

Those words could lead the reader to assume that a director is responsible for negligence in discharging his or her duties. But in Minnesota and across the country, this straightforward reading is subject to an important interpretational gloss that covers these words. When a director is sued for his or her allegedly negligent conduct, the director will be *excused* from liability where the director made “an informed business decision, in good faith, [and] without an abuse of discretion.”²⁴

Significantly, the director receives the benefit of the presumption that his or her actions complied with that standard.²⁵

17. See *infra* Part II.C.

18. See *infra* Part III.

19. See *infra* Part IV.

20. See *infra* Part V.

21. See *infra* Part VI.

22. MINN. STAT. § 302A.201, subdiv. 1 (2008).

23. MINN. STAT. § 302A.251, subdiv. 1 (2008).

24. *Janssen v. Best & Flanagan*, 662 N.W.2d 876, 882 (Minn. 2003).

25. *In re UnitedHealth Group, Inc. S'holder Derivative Litig.*, 754 N.W.2d 544, 551 (Minn. 2008). See also MINN. STAT. § 302A.251 (2008). “[T]he board of directors is presumed to be disinterested and to have acted on an informed basis,

Even if a director makes a decision that subsequently harms the corporation, despite the statute's express language, the director is excused from liability provided that the error was made in good faith and based on reasonable inquiry.²⁶ This interpretation is known as the "business judgment rule."²⁷ Courts recognize that directors manage risk-taking in their everyday decisions.²⁸ Assuming the decisions are well-informed, courts should not judge the decisions, in the light of hindsight, on the basis that directors were negligent for assuming a particular risk.²⁹ Simply put, courts do not hold directors liable for business decisions just because the decisions did not produce the best result for the corporation.

To defeat this presumption, the plaintiff must plead facts that, if true, would show that a director either made a poorly informed decision or acted in bad faith, thereby breaching the duty of care or the duty of loyalty respectively.³⁰ Before examining how the business judgment rule relates to derivative suits, the reader should first understand that settlements, not verdicts, are the most common results of director or officer misconduct. Part of the reason for this can be explained by the concepts behind indemnification and directors' and officers' insurance.

B. Indemnification: Smith v. VanGorkom's Effect on Director's Accountability

A director who breaches the duty of care in Minnesota is entitled to indemnification in accordance with section 302A.521 of

in good faith, and in the honest belief that the action taken was in the best interests of the corporation." Michael Dooley & Norman Veasey, *The Role of the Board in Derivative Litigation: Delaware Law and the Current ALI Proposals Compared*, 44 BUS. LAW. 503, 504-05 (1989) (citing *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984)). "Because of this presumption of sound business judgment, the board's decisions 'will not be disturbed by court if they can be attributed to any rational business purpose.'" *Id.* at 505 (citing *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971)).

26. See MINN. STAT. § 302A.251, subdiv. 1 (2008).

27. 1 DENNIS J. BLOCK, NANCY E. BARTON & STEPHEN A. RADIN, *THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS* 39 (5th ed. 1998). The Minnesota Supreme Court confirmed that section 302A.251 is the codified version of Minnesota's business judgment rule. *In re UnitedHealth Group, Inc. S'holder Derivative Litig.*, 754 N.W.2d 544, 551 (Minn. 2008).

28. See, e.g., *Janssen v. Best & Flanagan*, 662 N.W.2d 876, 882 (Minn. 2003).

29. Dooley, *supra* note 25, at 519.

30. See, e.g., *Westgor v. Grimm*, 318 N.W.2d 56, 58-59 (Minn. 1982); BLOCK, *supra* note 27, at 27-28.

the Minnesota Statutes.³¹ The same section allows the board to advance defense costs subject to board approval and control.³² Indemnification provides effective protection for a director if the board is friendly, if the corporation has the requisite assets to satisfy the obligation, and if the director meets the statutory standard.³³ Moreover, as a condition of accepting their appointment to the board, many directors request or require that the corporation provide Directors and Officers (hereinafter “D&O”) insurance coverage.³⁴ These policies, which are frequently written in indemnification and not defense coverage format,³⁵ may provide insurance coverage to individual directors as well as to the corporation itself.³⁶ Thus, short of fraud, bad faith, or certain kinds of illegal behavior, a director could reasonably expect to avoid personal liability given the availability of indemnification or insurance coverage.³⁷

In 1985, the Delaware Supreme Court decided *Smith v. Van*

31. MINN. STAT. § 302A.521, subdiv. 2(a)(1)–(5) (2008). A director could be indemnified if he or she:

(1) has not been indemnified by another organization [for the same lawsuit] . . . ; (2) acted in good faith; (3) received no improper personal benefit and section 302A.255, if applicable, has been satisfied; (4) in the case of a criminal proceeding, had no reasonable cause to believe the conduct was unlawful; and (5) in the case of acts or omissions occurring in the official capacity . . . reasonably believed that the conduct was in the best interests of the corporation[,] or [for director, officer, employee, or agent of the corporation who serves at the request of the corporation for another organization,] reasonably believed that the conduct was not opposed to the best interests of the corporation.

Id.

32. MINN. STAT. § 302A.521, subdiv. 6(a)(1) (2008) (“All determinations whether indemnification . . . is required . . . shall be made . . . by the board by a majority of a quorum, if the directors who are at the time parties to the proceeding are not counted for determining either a majority or the presence of a quorum . . .”).

33. As a matter of fact, a corporation *needs* indemnification to recruit future directors; otherwise, no reasonable candidate would agree to serve in a position that could expose him or her to liability for losses that range in the millions. See 2 DENNIS J. BLOCK, NANCY E. BARTON & STEPHEN A. RADIN, *THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS* 1853 (5th ed. 1998).

34. *Id.* at 1853–54.

35. See David M. Balabanian, *Civil RICO Litigation*, 313 PLI/LIT 675, 677 (1986) (“The typical D & O policy is written as an ‘indemnity’ policy, not a ‘liability’ policy.”).

36. Bennett L. Ross, *Protecting Corporate Directors and Officers: Insurance and Other Alternatives*, 40 VAND. L. REV. 775, 783 (1987).

37. See MINN. STAT. § 302A.521, subdiv. 2(a) (2008).

Gorkom,³⁸ holding the entire board of directors of the Trans Union Corporation liable for gross negligence by reason of not paying sufficient attention to a transaction involving the sale of the business.³⁹ Insurers writing D&O coverage grew nervous about their possible financial exposures.⁴⁰ As a result, the market for obtaining such coverage became thin.⁴¹ Some directors in Minnesota are said to have resigned shortly after this decision due to their concerns about the continuing availability of reasonably priced and termed D&O coverage.⁴²

In response, the Delaware Bar promptly stepped up to the plate. It drafted and then negotiated through the Delaware Legislature a statutory amendment authorizing shareholders to amend corporate articles of incorporation so as to *immunize* directors from liability for negligent performance of their duties as members of the board.⁴³ The Minnesota Legislature, at the urging of the corporate bar, promptly copied that statute into Minnesota law.⁴⁴ Many Minnesota corporations then obtained favorable shareholder votes amending articles so as to provide the

38. 488 A.2d 858 (Del. 1985).

39. See *id.* at 864. Very recently, this case was overruled by the Delaware Supreme Court decision, *Gantler v. Stephens*, but for different reasons. *Gantler v. Stephens*, 965 A.2d 695, 713 (Del. 2009). *Van Gorkom* held that shareholder ratification of a director's decision extinguished the shareholder claim completely. 488 A.2d at 889–90. Now, that is not necessarily the case; the challenged director decision remains subject to the business judgment rule (unless the claim asserted lack of authority). *Gantler*, 965 A.2d at 713.

40. See Roberta Romano, *What Went Wrong with Directors' and Officers' Liability Insurance?*, 14 DEL. J. CORP. L. 1, 24–25 (1989).

41. *Id.*

42. See Laurie Baum with John A. Byrne, *The Job Nobody Wants*, BUS. WK., Sept. 8, 1986, at 56.

43. DEL. CODE ANN. tit. 8, § 102(b)(7) (Supp. 1986). “Section 102(b)(7) was signed into law on June 18, 1986 and became effective July 1, 1986.” Ronald E. Mallen & David W. Evans, *Surviving the Directors' and Officers' Liability Crisis: Insurance and the Alternatives*, 12 DEL. J. CORP. L. 439, 472 n.92 (1987). There were however, restrictions on the indemnification provided:

[S]uch provision shall not eliminate or limit the liability of a director: (i) for any breach of the director's duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; (iii) under § 174 of this title; or (iv) for any transaction from which the director derived an improper personal benefit. No such provision shall eliminate or limit the liability of a director for any act or omission occurring prior to the date when such provision becomes effective.

DEL. CODE ANN. tit. 8, § 102(b)(7) (Supp. 1986).

44. MINN. STAT. § 302A.521, subdiv. 2(a)(1)–(5) (1986).

appropriate immunization for negligence (but not breach of duty of loyalty, bad faith, or illegal misconduct) by directors.⁴⁵

In Minnesota, a finding of breach of duty of loyalty, bad faith, or illegal misconduct generally requires either an admission, a determination by a disinterested board, or an adjudication of such a finding. Absent an admission or finding of such liability, indemnification is mandatory.⁴⁶ Consequently, settlement of a lawsuit, rather than adjudication, makes it likely that a director will qualify for indemnification or insurance coverage or both.⁴⁷ Except as covered by insurance, the liability for the loss is then shifted from the director to the corporation and thus to the shareholders generally.⁴⁸

Plaintiffs in both derivative and securities law violation cases often settle rather than litigate to adjudication for various reasons, one being that adjudicated violations of the federal securities laws are neither indemnifiable nor generally insurable.⁴⁹ Thus, a plaintiff who pursues the case to final judicial determination runs the risk of recovering only from the pocket of the defendant rather than the presumptively much more ample pocket of the company or the insurer.⁵⁰

Additionally, settlements are often attractive to plaintiffs faced with problems of proof, such as the requisite *scienter* under Rule 10b-5.⁵¹ The central question for the director (and for the corporation and its shareholders in terms of who bears the loss) often becomes not so much whether the lawsuit has merit (although that remains important), but rather who should be able

45. See, e.g., Third Restated Articles of Incorporation of UnitedHealth Group Incorporated, Section 7(a), available at http://unitedhealthgroup.com/about/third_amended_and_restated_articles_of_incorporation.pdf.

46. MINN. STAT. § 302A.521, subdiv. 2(a) (2008). It is of course subject to statutory limitations as well. *Id.*

47. The absence of a finding of liability increases the probability that an insurer will provide coverage under a D&O policy. Cf. BLOCK, *supra* note 33, at 1851 (“The more likely it is that lawsuits against directors will not be resolved in favor of directors at an early stage of litigation, the more likely it is that indemnifiable and/or insured against defense costs (particularly attorneys’ fees) will be high . . .”).

48. This brings the concept of indemnification to the public policy criticism that corporate funds should not be used to excuse directors for misconduct. See *id.* at 1969.

49. See Bernard Black et al., *Outside Director Liability*, 58 STAN. L. REV. 1055, 1097–98 (2006).

50. See *id.*

51. 17 C.F.R. § 240.10b-5 (2008).

to decide whether the lawsuit should be settled and, if so, on what terms to settle the suit.

Now that settlements have become the focus of our discussion, we can explore how they are handled in derivative suits under the guidance of the business judgment rule.

C. Shareholders' Remedies: The Derivative Suit

1. The Basics: How It Differs from Class Actions and How It Was Used in UnitedHealth.

When shareholders allege that the directors have violated the duty of care or the duty of loyalty, and the injury is to all shareholders alike, then any suit alleging liability must be brought in the name of the corporation and for the benefit of all the shareholders.⁵² In these circumstances, permitting individual suits by separate shareholders would waste time and money.⁵³ Only where the plaintiff can allege separate and distinct injury to him or herself may the plaintiff sue directly and not derivatively.⁵⁴ Suits brought on behalf of all shareholders, then, are denoted as “derivative.”⁵⁵

Thus, the state and federal derivative suits against officers and directors of UHG were brought in the name of UHG and for the benefit of all shareholders alike.⁵⁶ On the other hand, the class action suit for alleged violation of the federal securities laws was brought to recover for loss caused to the individual members of the class.⁵⁷ For instance, a shareholder who had bought or sold in reliance on the misstated financials issued by the corporation during the class period would sue for his or her own recovery and

52. See 2 BLOCK ET AL., *supra* note 33, at 1379–80 (quoting *Kamen v. Kemper Fin. Services, Inc.*, 500 U.S. 90, 95 (1991)).

53. 2 COX & HAZEN, CORPORATIONS § 15.03 (2d ed. 2003).

54. *Id.* § 15.02.

55. BLOCK, *supra* note 33, at 1380 (“[t]he claim is brought *derivatively* because ‘those in control of the company refuse or fail to assert’ the claim belonging to the corporation”) (quoting *Ala. By-Products Corp. v. Cede & Co.*, 657 A.2d 254, 264 (Del. 1995)).

56. See Amended Consolidated Derivative and Class Action Complaint, *supra* note 4 (in the Prayer for Relief, the shareholder plaintiffs asked for relief to be granted to UHG).

57. See Class Action Complaint, *supra* note 3 (in their prayer for relief, the plaintiffs did not ask for “injunctive relief in favor of the corporation,” but rather in favor of themselves).

not for the benefit of all shareholders.⁵⁸

2. *The Stages of the Derivative Suit*

A derivative suit is a potential asset of the corporation, and as such, is subject to the control and management of the board unless, for any reason, the board is disqualified from fairly exercising such control and management.⁵⁹ This concept can be traced back to its origins in a case before an English court in the early 1800s.⁶⁰

Given the board's authority to control derivative suits, a potential plaintiff must either make a demand on the board that it bring suit against the wrongdoers,⁶¹ or allege to the court with particularity that, due to having a conflict of interest, the board is

58. Justice Frankfurter depicts a good example: "if a corporation rearranges the relationship of different classes of security-holders to the detriment of one class, a stockholder in the disadvantaged class may proceed against the corporation" 2 COX & HAZEN, *supra* note 53, § 15.02 (citing *Smith v. Sperling*, 354 U.S. 91 (1957) (Frankfurter, J., dissenting)). In *UnitedHealth*, the corporation (shareholders generally) paid the individual members of the class \$895 million under the terms of the settlement. See STANFORD REPORT, *supra* note 3.

59. BLOCK, *supra* note 33, at 1380. The derivative suit nevertheless equates to the procedure by which shareholders "compel the corporation to sue." *Id.* at 1381 (quoting *Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1984)).

60. *Hidrens v. Congreve*, 38 Eng. Rep. 917 (1828). More derivative cases followed *Hidrens*. In one case, two shareholders of a corporation, the Victoria Park Company, sued the directors for fraud and other "illegal transactions." *Hawes v. City of Oakland*, 104 U.S. 450, 454-55 (1881) (referring to *Foss v. Harbottle*, 67 Eng. Rep. 189 (1843)). The court upheld the defendant directors' demurrer motion because the plaintiffs neither obtained an action from the majority of the shareholders nor showed that no acting board could otherwise bring the suit. *Id.* More simply put, minority shareholders should not litigate internal disputes because the corporation, as an entity, must first decide whether litigation is even appropriate. *Id.* Therefore, either the majority of shareholders or the directors decided this matter unless they abused that power through fraud or other illegal conduct. See *id.* (referring to *MacDougall v. Gardiner*, (1875) 1 Ch.D. 13). As shown by *Hawes*, U.S. courts still required shareholders to first "induce remedial action" by the board so long as it was feasible. *Id.* at 460-61.

61. See 2 COX & HAZEN, *supra* note 53, § 15.06 (citing a number of cases as examples, including *Hawes v. City of Oakland*, 104 U.S. 450, 460-61 (1882); *Barr v. Wackman*, 329 N.E.2d 180 (N.Y. 1975); and *Fleer v. Frank H. Fleer Corp.*, 125 A. 411, 414 (Del. Ch. 1924)). "The demand must, at a minimum, 'identify the alleged wrongdoers, describe the factual basis of the wrongful acts and the harm caused to the corporation, and request remedial relief.'" 2 BLOCK ET AL., *supra* note 33, at 1428 (quoting *Allison v. Gen. Motors Corp.*, 604 F. Supp. 1106, 1117 (D. Del.), *aff'd mem.*, 782 F.2d 1026 (3d Cir. 1985)).

incapable of asserting or maintaining the lawsuit.⁶² Should the plaintiff make a demand, at least under applicable Delaware law, the plaintiff confesses that the board can control and manage the lawsuit effectively.⁶³ In the absence of a conflict of interest, the board's decision with respect to the demand and the maintenance or termination of the suit is reviewed under the business judgment rule.⁶⁴

If, on the other hand, the plaintiff alleges with particularity that the board is, by reason of conflict of interest, incapable of such management, then the court may recognize that demand would be futile.⁶⁵ If the plaintiff's claim survives a dismissal motion, the lawsuit is up and running and outside the management and control of the board.⁶⁶

In both the federal and state derivative suits involving UHG, the plaintiffs alleged such a conflict⁶⁷ and there was no dismissal of the complaints on the pleadings.⁶⁸ Now the reader could assume that if the plaintiff could survive a challenge to the allegation that the board was conflicted, then the plaintiff's suit would proceed to trial without further interference from the board. This, however, is

62. Nevertheless, shareholders may surpass this requirement by showing that their demand was either futile or "wrongfully refused." 2 BLOCK ET AL., *supra* note 33, at 1454–55. Wrongful refusal typically happens when the board negligently decides to forego a derivative suit or acts in bad faith. *See* 2 BLOCK ET AL., *supra* note 33, at 1608–1609 (citing *Stepak v. Addison*, 20 F.3d 398 (11th Cir. 1994)); *see also* 2 COX & HAZEN, *supra* note 53, at 928–29 (citing *Atkins v. Hibernia Corp.*, 182 F.3d 320, 324 (5th Cir. 1999)).

63. *See, e.g., Stotland v. GAF Corp.*, 469 A.2d 421, 423 (Del. 1983).

64. *See, e.g., United Copper Sec. Co. v. Amalgamated Copper Co.*, 244 U.S. 261, 263, 37 S.Ct. 509, 510 (1917); 2 BLOCK ET AL., *supra* note 33, at 1454–55; *see* E. Norman Veasey & Christine T. Di Guglielmo, *What Happened in Delaware Corporate Law and Governance From 1992–2004? A Retrospective on Some Key Developments*, 153 U. PA. L. REV. 1399, 1465–1466 (2005).

65. Demand futility commonly occurs when the directors commit the misconduct at issue. *See* 2 COX & HAZEN, *supra* note 53, at 922 (citing *Wolgin v. Simon*, 722 F.2d 389 (8th Cir. 1984)). It also occurs when the directors are otherwise interested in the legal matter. *See* 2 BLOCK ET AL., *supra* note 33, at 1467–68 (citing *Harris v. Carter*, 582 A.2d 222, 228 n.12 (Del. Ch. 1990)).

66. *See* 2 COX & HAZEN, *supra* note 53, at 922.

67. *See* Amended Consolidated Derivative and Class Action Complaint, *supra* note 4, at ¶ 272 ("Plaintiffs did not make a demand . . . because . . . there is not a majority of disinterested and independent directors on UnitedHealth's board to appropriately consider a demand as all of UnitedHealth's twelve directors have disabling interests or conflicts. As such, demand should be excused.").

68. *See In re UnitedHealth Group Inc. S'holder Derivative Litig.*, Nos. 06-CV-1216 (JMR/FLN), 06-CV-1691 (JMR/FLN), 2007 WL 4571127 (D. Minn. Dec. 26, 2007) (by this point, the court had not dismissed any of the complaints).

not the case.⁶⁹ Boards have been given broad authority to create committees and charge those committees with conduct of board business as delegated.⁷⁰ This authority includes managing lawsuits.⁷¹ But could a board that was itself conflicted nevertheless appoint a committee of persons who were not members of the board and charge them with authority to manage and even dismiss the case? Could such a committee so appointed do something that the board itself could not do?

In *Zapata v. Maldonado*,⁷² a derivative complaint was filed in Delaware alleging that demand should be excused because of board conflict.⁷³ The conflicted board appointed an SLC consisting of persons who were not board members.⁷⁴ The SLC then moved to terminate the lawsuit as being not in the best interests of the corporation.⁷⁵ The plaintiff challenged the ability of a conflicted board to so act, but the Delaware Supreme Court held that, subject to conditions reviewed below, such an SLC could decide effectively that the lawsuit be terminated, thus cutting the ground out from underneath the plaintiff.⁷⁶ Two years earlier, the New York Court of Appeals held in *Auerbach v. Bennett*⁷⁷ that in a similar situation an SLC could so decide, but its decision would receive significantly greater judicial deference than that in *Zapata*.⁷⁸

The following section shows how directors can appoint an

69. See *Abbey v. Control Data Corp.*, 603 F.2d 724, 728 (8th Cir. 1979). The court rejected the shareholder plaintiffs' argument, in the words derived from *Lasker v. Burks*, that "disinterested directors of an investment company do not have the power to foreclose the continuation of nonfrivolous litigation brought by shareholders against majority directors for breach of their fiduciary duties." *Id.* at 728 (quoting *Lasker v. Burks*, 567 F.2d 1208, 1212 (2d Cir. 1978), *rev'd* 441 U.S. 471 (1979)). The reason was that the *Lasker* decision was later reversed. See *Burks v. Lasker*, 441 U.S. 471, 99 S.Ct. 1831 (1979). The *Abbey* court concluded that an independent committee, appointed even by a minority of the board members, enjoyed business judgment rule protection since the business judgment rule "applies to any reasonable good faith determination by an independent board of directors that the derivative action is not in the best interests of the corporation." *Abbey*, 603 F.2d at 730.

70. MINN. STAT. § 302A.241 (2008).

71. *Id.* at subdiv. 1.

72. 430 A.2d 779 (Del. 1981).

73. *Id.* at 780.

74. *Id.* at 781.

75. *Id.*

76. *Id.* at 789 ("If the Court's independent business judgment is satisfied, the Court may proceed to grant the motion, subject, of course, to any equitable terms or conditions the Court finds necessary or desirable.").

77. 393 N.E.2d 994 (N.Y. 1979).

78. See *id.* at 999-1000; see also *Zapata*, 430 A.2d at 788-89.

independent SLC even though that suit is based on a well-pleaded conflict of interest with respect to the board. Because an SLC can trump a well-pleaded complaint, the reader should keep in mind that the rules relating to selection of the members of an SLC, delegation of authority to the SLC, and performance of the responsibilities so delegated by the SLC, should be subject to some measure of judicial oversight and review.

III. SLCs

A. *Auerbach and Zapata: Minnesota's Starting Point for Reviewing SLCs.*

Minnesota courts have reviewed SLC decisions under the guidance of the business judgment rule.⁷⁹ Under this rule, courts have upheld SLC decisions if the SLC was independent from the corporation and investigated the matter adequately and in good faith.⁸⁰ Prior to *UnitedHealth*, it was unclear under Minnesota law whether SLC recommendations required factual support or merely a showing that the SLC investigated the suit adequately and in good faith.⁸¹ Across the country, two conflicting ideas developed with respect to how strictly courts should review SLC recommendations.

In *Auerbach v. Bennet*,⁸² the New York Court of Appeals limited judicial review to assessing whether the SLC independently investigated the derivative suit with appropriate procedure and in good faith.⁸³ The underlying derivative complaint in that case alleged that certain members of the board were involved in illegal

79. See *Janssen v. Best & Flanagan*, 662 N.W.2d 876, 884 (Minn. 2003). See also MINN. STAT. § 302A.251 (2008).

80. See *Black v. NuAire, Inc.*, 426 N.W.2d 203, 209–10 (Minn. Ct. App. 1988). While this standard was not expressly accepted in *Janssen*, it was nevertheless applied by *Janssen* without any changes. See *Janssen*, 662 N.W.2d at 884.

81. See *In re UnitedHealth Group, Inc. S'holder Derivative Litig.*, Nos. 06-CV-1216, 06-CV-1691, 2007 WL 4571127, at *7 (D. Minn. Dec. 26, 2007).

82. 393 N.E.2d 994 (N.Y. 1979).

83. *Id.* at 1002–03. The question of adequacy regarding investigatory methods depends on the “nature and characteristics of the particular subject being investigated” *Id.* at 1003. In this case, the SLC consisted of three members, which decided the outcome of a suit against four directors of a fifteen-member board. *Id.* at 1001. The court upheld the SLC’s motion to dismiss the suit, because the committee selected the appropriate procedures. *Id.* at 1002. The court went on to say that the decision was thus properly based on the investigation and was outside the scope of review. *Id.*

overseas payments (bribes) over a period of years.⁸⁴ The board appointed an SLC consisting of three directors who joined the board after the occurrence of these alleged payments.⁸⁵ The SLC was given full authority (without review by the board) to handle the lawsuit.⁸⁶ Based on the SLC's decision, the supreme court dismissed the plaintiff's suit; subsequently, however, the appellate division reversed.⁸⁷

On further appeal, the New York Court of Appeals sustained dismissal of the complaint, concluding that "the determination of the special litigation committee forecloses further judicial inquiry in this case."⁸⁸ The business judgment rule required this outcome "absent evidence of bad faith or fraud (of which there is none here)."⁸⁹ The court observed that "the business judgment rule does not foreclose inquiry by the courts into the disinterested independence of those members of the board chosen by it to make the corporate decision on its behalf" but concluded that nothing in the record raised a triable fact issue regarding the SLC's independence.⁹⁰ The court further recognized that "the selection of procedures" was appropriate and "the ultimate substantive decision . . . not to pursue the claims" was based on these procedures.⁹¹ Under this recognition, the court concluded that there was no need to examine the substantive findings, for doing so would intrude improperly on the business judgment rule.⁹²

In *Zapata v. Maldonado*,⁹³ the Delaware Supreme Court introduced a potentially stricter judicial scrutiny of SLC decisions, suggesting the importance of ensuring that the SLC report would contain findings and well reasoned conclusions.⁹⁴ This court prescribed a two-step standard. The first step involved an

84. *Id.* at 997.

85. *Id.*

86. *Id.*

87. *Id.* at 998.

88. *Id.* at 1000.

89. *Id.*

90. *Id.* at 1001.

91. *Id.* at 1002.

92. *Id.*

93. 430 A.2d 779 (Del. 1981).

94. *See id.* In this case, a stockholder brought action to recover against ten officers and directors for breaches of fiduciary duties. *Id.* at 780. The board elected an SLC, which concluded that the derivative suit should be dismissed. *Id.* at 781. The defendant moved for dismissal or summary judgment. *Id.* at 780. The trial court granted the summary judgment motion and the plaintiff appealed. *Id.* at 781.

assessment of the SLC's good faith and independence similar to the *Auerbach* process.⁹⁵ The court retained, however, a second discretionary step, in which it might exercise its own "business judgment" in determining whether to grant the SLC's motion to dismiss the derivative suit.⁹⁶ Delaware courts have not applied the second step in every case, but rather only when "corporate actions meet the criteria of step one, but the result does not appear to satisfy its spirit, or where corporate actions would simply prematurely terminate a stockholder grievance deserving of further consideration in the corporation's interest."⁹⁷

The *Zapata* court supported its adoption of this two-step standard by emphasizing that if SLCs are not required to provide substantive support for their recommendations, "corporations can consistently wrest bona fide derivative actions away from well-meaning derivative plaintiffs through the use of the committee mechanism," causing the derivative suit to lose effectiveness as a policing tool.⁹⁸

B. How the Conflict Between Auerbach and Zapata Influenced Minnesota Case Law Before UnitedHealth.

Prior to *UnitedHealth*, Minnesota courts seemingly applied the *Auerbach* standard, but had not explicitly disavowed review of the SLC report in the "business judgment" of the court.⁹⁹ Nevertheless, the history behind the *Auerbach-Zapata* clash in Minnesota helps illustrate how the *UnitedHealth* court decided which standard of review to choose.

The Minnesota legislature codified the permitted use of SLCs in 1981.¹⁰⁰ For the first time since this codification, the Minnesota Court of Appeals confronted the issue of how it should review an

95. *Id.* at 788. However, the task of ensuring good faith and independence included substantively reviewing the SLC's findings. *See id.* at 788–89.

96. *Id.* at 789.

97. *Id.*

98. *Id.* at 786.

99. *See, e.g., Janssen v. Best & Flanagan*, 662 N.W.2d 876, 889 (Minn. 2003) (acknowledging the past support for the *Auerbach* standard yet declining to affirm whether a more exacting standard of review is necessary).

100. Act of May 27, 1981, ch. 270, § 43, 1981 Minn. Laws 1141, 1168 (codified at MINN. STAT. § 302A.243 (1982)), *repealed by* Act of May 19, 1989, ch. 172, § 11, 1989 Minn. Laws 421, 429. The state statute mandated that SLCs shall be composed of either two or more disinterested directors or independent persons to decide whether pursuing litigation will best serve the corporation. MINN. STAT. § 302A.243 (1982).

SLC report in *Black v. NuAire, Inc.*¹⁰¹ NuAire Inc. (“NuAire”) designed, produced, and sold air filtering devices for medical and industrial research.¹⁰² The plaintiff was a NuAire shareholder who alleged that NuAire breached the duty of loyalty by awarding Max Peters, a director and major shareholder, grossly excessive compensation.¹⁰³

Thereafter, an independent member of the NuAire board appointed an SLC, which concluded that except for a deferred compensation agreement entered into with Max Peters, all other charges were meritless.¹⁰⁴ Hence, the SLC proposed terminating the lawsuit so long as the board would rescind the deferred compensation agreement.¹⁰⁵ Once the board rescinded the agreement, the trial court dismissed the suit, reasoning that the SLC had been comprised of disinterested members and investigated the matter in good faith.¹⁰⁶

On appeal, the plaintiffs asked the court to review the merits of the committee’s recommendations.¹⁰⁷ The court of appeals declined, stating that “the trial court properly limited its inquiry to whether the appointed committee members were disinterested within the meaning of section 302A.243 and conducted their investigation in good faith.”¹⁰⁸

The court of appeals revisited this issue in *Drilling v. Berman*.¹⁰⁹ In *Drilling*, the court examined how subsequent Minnesota legislation had affected the issue of reviewability of SLC decisions:

Prior to 1989, Minn. Stat. § 302A.243 (1988) restricted judicial review of a special litigation committee decision to terminate a derivative suit to a determination of whether the committee was disinterested and made its decision in good faith. In 1989, the legislature repealed Minn. Stat. § 302A.243. In repealing the section, the legislature made it

101. 426 N.W.2d 203 (Minn. Ct. App. 1988).

102. *Id.* at 205.

103. *See id.* at 205–06. Additional allegations included: “(1) wrongful hiring of relatives; (2) excessive salaries and business expenses; (3) wrongful Turnpike Investment transactions; (4) illegal diversion of NuAire funds; (5) secrecy and concealment of unlawful acts; (6) failure to pay dividends; and (7) excessive fringe benefits[.]” *Id.* at 206.

104. *Id.*

105. *Id.* at 206–07.

106. *Id.* at 207.

107. *Id.* at 208–09.

108. *Id.* at 211.

109. 589 N.W.2d 503 (Minn. Ct. App. 1999).

clear it was not commenting on the substance of the section and that its repeal ‘must be interpreted in the same manner as if section 302A.243 had not been enacted.’ The legislature took that action in recognition that Minnesota was one of the few states with legislation governing judicial review of special litigation committees. The repeal represented ‘a commitment to let the caselaw develop,’ and a desire to give our courts flexibility.¹¹⁰

The *Drilling* court acknowledged the thoroughness of the SLC process: the SLC “reviewed thousands of documents provided by the parties. It also interviewed four witnesses.”¹¹¹ But the plaintiffs argued that the SLC failed to demonstrate good faith because their conclusions were not explained.¹¹² The court countered that good faith is not measured by the substance, but rather the nature of the investigation.¹¹³ To measure the adequacy of the SLC’s investigation, the *Drilling* court adopted factors used by the Tennessee Court of Appeals in *Lewis v. Boyd*,¹¹⁴ which included: “(1) the length and scope of the investigation, (2) the committee’s use of independent counsel or experts, (3) the corporation’s or the defendant’s involvement, if any, in the investigation, and (4) the adequacy and reliability of the information supplied to the committee.”¹¹⁵

Thus far, the appellate court decisions suggested that perhaps the *Auerbach* approach provided the appropriate standard of review for SLC decisions in Minnesota. Prior to the *UnitedHealth* case however, *Janssen v. Best & Flanagan*¹¹⁶ was the only Minnesota Supreme Court decision that addressed this issue.¹¹⁷ In *Janssen*, a derivative suit was brought by a nonprofit corporation, the Minneapolis Police Relief Association (“MPRA”), for an alleged negligently conducted business investment.¹¹⁸ The investment

110. *Id.* at 506 (citations omitted).

111. *Id.*

112. *Id.* at 507.

113. *Id.* at 509. The court further clarified that good faith is not shown by proper substantive support but rather appropriate procedures and methodologies. *Id.*

114. 838 S.W.2d 215, 224 (Tenn. Ct. App. 1992).

115. *Drilling*, 589 N.W.2d at 509 (citing *Boyd*, 838 S.W.2d at 224). Note that none of these factors pertain to the factual basis for conclusions and recommendations.

116. 662 N.W.2d 876 (Minn. 2003).

117. *Id.*

118. *Id.* at 879.

allegedly cost the company \$15 million.¹¹⁹ Unlike the general Minnesota corporation statute, the nonprofit statute, chapter 317A, did not have a provision comparable to section 302A.241 expressly authorizing the appointment of SLCs.¹²⁰ Nevertheless, the supreme court held that the power to do so was necessarily implicit in the nonprofit statute.¹²¹

The *Janssen* case illustrates that SLCs are not necessarily infallible. The MPRA appointed Robert A. Murnane, an attorney, to investigate the derivative suit.¹²² The MPRA specifically instructed Murnane not to review the “factual findings, determinations, events or circumstances” described in prior reports and discovery materials in a similar lawsuit.¹²³ Because this instruction restricted the scope of the SLC investigation, the supreme court agreed with the lower court that “Murnane, as a special litigation committee, failed to meet the threshold test of independence and good faith,” and allowed the lawsuit to proceed.¹²⁴

In so ruling, the court further critiqued Murnane’s investigation on which he based his conclusion as SLC:

In addition, we conclude that Murnane did not engage in a good faith attempt to deduce the best interest of MPRA with respect to the litigation against Best & Flanagan. Murnane never interviewed Janssen or their attorneys, a fundamental task in reaching an informed decision about the merits of their complaints. Murnane also gave no indication that he had undertaken the careful consideration of all the germane benefits and detriments to MPRA that is indicative of a good faith business decision.¹²⁵

The court then refused to recognize the subsequent attempt of the MPRA to give Murnane a general and unlimited instruction holding that the initial delegation of authority to the SLC must be complete and not subject to subsequent amendment or further

119. *Id.*

120. MINN. STAT. § 317A.241 (2008).

121. *Janssen*, 662 N.W.2d at 883–84, 88.

122. *Id.* at 880.

123. *Id.*

124. *Id.* at 888. This rule is otherwise known as the one-strike rule. For an analysis of the one-strike rule, see Eric J. Moutz, *Janssen v. Best and Flanagan: At Long Last, The Beginning of the End for the Auerbach Approach in Minnesota?*, 30 WM. MITCHELL L. REV. 489, 504–09 (2003).

125. *Janssen*, 662 N.W.2d at 889.

oversight by the board.¹²⁶

Therefore, up to this point, Minnesota law suggested that substantive judicial review of the process followed by an SLC *might* be appropriate for deciding whether the SLC was independent and acted in good faith.¹²⁷ In the course of the UnitedHealth litigation, specifically when the SLC report arrived on Federal District Court Chief Judge Rosenbaum's desk, he expressed concerns about the report and found the need to ask the Minnesota Supreme Court for advice. He observed:

The Special Litigation Committee[']s . . . lack of any findings leaves no tracks showing why or how its business judgment can be considered reasonable. . . . Ultimately, the Court asks whether Minnesota law makes an SLC an impenetrable "black box," whose decisions and evaluative processes are immune from review in a shareholders' derivative suit. Put another way, does the business judgment rule foreclose any action, beyond the Court's rubber stamping an SLC's decision?¹²⁸

As the reader will see, the Minnesota Supreme Court answered his question, but may not have solved the problems he raised.

IV. IN RE *UNITEDHEALTH GROUP INC.* SHAREHOLDER DERIVATIVE LITIGATION

A. *Facts and Procedure*

In March of 2006, a *Wall Street Journal* article suggested that a number of different corporations in this country were possibly backdating stock options.¹²⁹ One of the companies mentioned was

126. See *id.* at 889–90.

127. See Moutz, *supra* note 124, at 511. Moutz explains that *Janssen* did not directly address the propriety of these decisions, but it did present a framework that, if followed in subsequent decisions, would seem to suggest that a less-deferential approach to special litigation committee decisions is now the law of Minnesota. The precise contours of this new approach have yet to be defined by the courts, but the fundamental logic of *Janssen* and strong public policy concerns suggest that a version of the *Zapata* or *Miller* approaches may be appropriate.

Id. (emphasis added).

128. *In re UnitedHealth Group, Inc.*, S'holder Derivative Litig., Nos. 06-CV-1216, 06-CV-1691, 2007 WL 4571127, at *6 (D. Minn. Dec. 26, 2007) (referring to MINN. STAT. § 480.065, subdiv. 3 (2006)).

129. Forelle & Bandler, *supra* note 1, at A1.

UnitedHealth, a Minnesota corporation.¹³⁰ According to the article, Dr. William McGuire, who was then UHG's CEO, received a large block of options that just happened to be dated the day UHG stock prices hit their low for the year—"unusually propitious" timing.¹³¹ The *Journal* article, referring to a pattern of such awards, stated that "the odds of such a favorable pattern occurring by chance would be one in 200 million or greater."¹³² The article also mentioned that an SEC inquiry was underway.¹³³

Why would "backdating" be a problem? The "date" of the grant would fix the strike price for exercise of the option and the potential value of the option would be the difference between that strike price and the market price at date of sale of the shares subject to the option.¹³⁴ This potential profit spread would be magnified by choosing as the date when the grant was allegedly issued a time when the UHG stock price was low.¹³⁵ Granting options with a strike price below the market price prevailing as of the date the option was granted would involve breach of the rules and policies established by board as well as shareholder action.¹³⁶ Moreover, it would require complex adjustments to UHG's accounting for the cost of such options.¹³⁷ Issuing UHG financials that failed to account for such adjustments, if required, would constitute the provision of false information to persons buying and selling UHG stock on the market.¹³⁸ Stockholders would be led to conclude that UHG employee wages were less—and thus profits were more—than they actually were.¹³⁹

Shortly after the Wall Street Journal article was published, the SEC notified UHG that it had commenced an informal inquiry into

130. *In re UnitedHealth Group, Inc., S'holder Derivative Litig.*, 754 N.W.2d 544, 548 (Minn. 2008).

131. Forelle & Bandler, *supra* note 1, at A1.

132. *Id.* See also SLC Report, *supra* note 9, at 5.

133. Forelle & Bandler, *supra* note 1, at A1.

134. *Id.*

135. *Id.*

136. See Verified Derivative Action Complaint ¶ 4, *In re UnitedHealth Group, Inc. S'holder Derivative Litig.*, 591 F. Supp. 2d 1023 (D. Minn. 2008) (No. 0:06-cv-01216-JMR-FLN), available at http://securities.stanford.edu/1036/UNH_01/2006329_o01c_060121.pdf.

137. See Forelle & Bandler, *supra* note 1, at A2, ¶ 12.

138. See SEC Complaint, *supra* note 2.

139. See *id.* "[Backdating] caused investors to believe, falsely, that the Company granted options with strike prices equal to the fair market value of UnitedHealth stock on the date of grant." See *id.* ¶ 4.

UHG's stock option granting practices.¹⁴⁰ UHG then appointed a committee of directors to review UHG's stock option granting practices.¹⁴¹ This committee then retained the Wilmer Cutler law firm as counsel to assist in this review.¹⁴² Following a very intensive study and investigation, Wilmer Cutler reported to the committee that "[t]he measurement dates used by the Company for most of the option grants . . . under review were incorrect, and many of the option grants were likely backdated."¹⁴³ Grants to senior officers were approved by the board's compensation committee.¹⁴⁴ The chair of that committee also chaired an ad hoc committee appointed in 1999 to negotiate the long-term employment contracts for the CEO and the president at that time.¹⁴⁵ The employment contract for the CEO assured the grant of 1,000,000 options.¹⁴⁶

Significantly, the report noted that during this time frame, the chair of the compensation committee served as "a trustee for two trusts for the benefit of each of Dr. McGuire's children," managed assets for the CEO that fluctuated "from approximately \$15 million in 1996 to over \$55 million in 2006," and "accepted an investment of \$500,000 from Dr. McGuire in connection with [the chair's] repurchase of the money management firm that bears his name"¹⁴⁷ Stock option grants, the report noted, were regularly approved by written action of the board's compensation committee, and for a substantial number of these grants it was "determined that the Written Actions that were '[d]ate[d]' on a specific date were executed subsequently."¹⁴⁸

The wave of litigation had commenced earlier. On March 29, 2006, shareholders filed a derivative suit in federal district court in Minneapolis against various current and former officers and directors of UHG.¹⁴⁹ The shareholders alleged breaches of

140. WILMER CUTLER PICKERING HALE & DORR LLP, REPORT TO THE SPECIAL COMMITTEE OF THE BOARD OF DIRECTORS OF UNITEDHEALTH GROUP, INC., *available at* http://www.unitedhealthgroup.com/assets/shared/Wilmer_Hale_Report.pdf [hereinafter Wilmer Cutler Report] (last visited Oct. 19, 2009).

141. *Id.*

142. *Id.*

143. *Id.* at 4.

144. *Id.*

145. *Id.*

146. *Id.* at 13.

147. *Id.* at 8.

148. *Id.* at 5.

149. See Verified Derivative Action Complaint ¶ 1, Brandin v. McGuire, No.

fiduciary duty,¹⁵⁰ and their suit was later consolidated with various other derivative suits.¹⁵¹ Additionally, another lawsuit was filed in the Minnesota district court, alleging violations of federal securities laws and seeking court approval of the suit as a class action.¹⁵² The lead plaintiff in this suit was California Public Employees' Retirement System (CalPERS).¹⁵³ On April 24, 2006, a shareholder filed a state derivative suit in Hennepin County District Court, which was consolidated with other state court actions.¹⁵⁴

On October 31, 2008, UHG announced it had reached an agreement to settle the SEC's investigation.¹⁵⁵ Without admitting or denying the SEC's allegations, UHG agreed to a permanent injunction against any future violations of certain reporting, books and records, and internal accounting control provisions of the federal securities laws.¹⁵⁶

The SEC brought civil actions against both the former CEO and former general counsel that resulted in very large financial penalties and other injunctive relief. "[T]he parties reached a settlement in which [the CEO] agreed to return \$400 million to UnitedHealth and pay a \$7 million civil fine."¹⁵⁷ In settling the SEC action, McGuire agreed not to "make or permit to be made any public statement denying, directly or indirectly, any allegation in the [SEC] complaint or creating the impression that the complaint is without factual basis."¹⁵⁸

When the Wilmer Cutler report became public on October 15, 2006, the former CEO tendered his resignation, and on the same

06CV01216, 631 F. Supp. 2d 1151 (D. Minn. Mar. 29, 2006).

150. *Id.*

151. *See* Amended Consolidated Derivative and Class Action Complaint, *supra* note 4.

152. Class Action Complaint for Violations of the Federal Securities Laws, Krause v. UnitedHealth Group, Inc., No. 06 CV 1691 ADM/JSM, Fed. Sec. L. Rep. P 943442006 2006 WL 2427400 (D. Minn. May 5, 2006).

153. *See* Order Designating Lead Plaintiff and Plaintiff's Counsel, *In re* UnitedHealth Group, Inc. PSLRA Litig., No. 06-cv-01691 (D. Minn. Sept. 14, 2006), available at http://securities.stanford.edu/1036/UNH_01/2006914_f01x_061691.pdf.

154. *See* State Consolidated Derivative Complaint, *supra* note 5.

155. Defendant's Memorandum of Law in Support of SLC's Motions for Preliminary Approval and Dismissal, *In re* UnitedHealth Group Inc. S'holder Derivative Litig., No. 06-1216 (JMR/FLN), 631 F. Supp. 2d 1151 (D. Minn. Oct. 31, 2008), 2008 WL 4843870.

156. UnitedHealth Group Inc., Annual Report (Form 10-K/A), at 86 (Dec. 31, 2008), available at http://unitedhealthgroup.com/invest/2008/Final_10-K_2008.pdf.

157. *In re* UnitedHealth Group, Inc., S'holder Derivative Litig., 754 N.W.2d 544, 548 (Minn. 2008).

158. *Id.*

date the former general counsel left his position, retiring from UHG at the end of the year.¹⁵⁹ The chair of the compensation committee resigned that same month.¹⁶⁰

Earlier, on July 19, 2006, UHG had responded to the derivative suits by creating a two-member SLC under Minnesota Statutes section 302.241A, subdivision 1.¹⁶¹ In its report, the SLC listed legal defenses pertaining to each derivative claim, yet acknowledged that most claims had merit.¹⁶² It recommended a settlement and dismissal of the claims against the former CEO and the other defendants for both the state and federal derivative suits.¹⁶³

The proposed settlement called for the former CEO to relinquish approximately \$320 million in UHG stock options, surrender his rights to his UHG retirement plan and executive savings plan, and relinquish any claim he might have had to post-employment benefits.¹⁶⁴ The “total economic value” McGuire would relinquish under the settlement amounted to approximately \$420 million.¹⁶⁵ The proposed settlement also called for the former general counsel to repay earnings from the exercise of options in the amount of \$20.55 million, relinquish rights to severance benefits of \$1.95 million, and relinquish options to purchase 273,000 shares with a value of approximately \$5.5 million.¹⁶⁶ Together with earlier transactions, the total value relinquished to UHG was \$30.7 million.¹⁶⁷ Finally, a proposed settlement agreement recommended binding arbitration with the former Chair of the Compensation Committee over the fair settlement

159. SLC Report, *supra* note 9.

160. *Id.* at 17.

161. *In re UnitedHealth*, 754 N.W.2d at 548. Both SLC members formerly served on the Minnesota Supreme Court. *Id.* The two members furthermore sought guidance from Professor Lyman P.Q. Johnson regarding matters of corporate law and governance; Krolls Litigation Consulting and Forensics practice on accounting issues; and Professor Brad Cornell of CRA International on issues regarding economics and damages. SLC Report, *supra* note 9.

162. *See, e.g.*, SLC Report, *supra* note 9, ¶ IV.B. Until the SLC completed and issued its report, McGuire was prohibited by a preliminary injunction placed by the federal district court in the district of Minnesota on November 29, 2006, from “exercising any UnitedHealth stock options without court approval.” *In re UnitedHealth*, 754 N.W.2d. at 548.

163. SLC Report, *supra* note 9, ¶ IV.B.

164. *Id.*

165. *Id.*

166. *Id.* ¶ IV.C.

167. *Id.*

value of the claims against him in the derivative actions.¹⁶⁸

B. Judge Rosenbaum's Misgivings

Upon reviewing the SLC materials, Judge Rosenbaum, presiding over both the direct and derivative actions filed in the Minnesota Federal District Court, expressed concerns.¹⁶⁹ The end result, he suggested, would still allow the former CEO to retain \$800 million.¹⁷⁰ Moreover, the SLC report contained no specific findings or reasons supporting the SLC's conclusions that the derivative claims should all be dismissed:

The Special Litigation Committee has apparently made a business judgment favoring settling the Board's and UHG's possible claims against its former officers on terms outlined in its report. But its lack of any findings leaves no tracks showing why or how its business judgment can be considered reasonable. Its business judgment may close the inquiry, leaving a Court mute, and charged only with the ministerial duty to sign off on the deal and dismiss the derivative suit. Or there may be other alternatives. Ultimately, the Court asks whether Minnesota law makes an SLC an impenetrable "black box," whose decisions and evaluative processes are immune from review in a shareholders' derivative suit. Put another way, does the business judgment rule foreclose any action, beyond the Court's rubber stamping an SLC's decision?¹⁷¹

Since Judge Rosenbaum was unsure whether he had authority under Minnesota law to review the reasonableness of the SLC's decision,¹⁷² he certified to the Minnesota Supreme Court the following question: "Does Minnesota's business judgment rule foreclose a court from a) examining the reasonableness of, or b) rejecting on the merits, a settlement of a derivative action proposed by a Special Litigation Committee duly constituted under

168. *Id.* ¶ IV.D.

169. *See In re UnitedHealth Group, Inc., S'holder Derivative Litig.*, Nos. 06-CV-1216, 06-CV-1691, 2007 WL 4571127, at *6 (D. Minn. Dec. 26, 2007).

170. *Id.*

171. *Id.*

172. In trying to find the answer, the district court briefly summarized the history of Minnesota's case law and statutes, yet it could find no decisions affirming the *Auerbach* rule from the Minnesota Supreme Court; hence, it did not have the sufficient precedent to be certain. *See id.* at *6–7.

Minnesota Statutes § 302A.241 subd. 1?”¹⁷³

C. The Minnesota Supreme Court’s Decision and Underlying Analysis

The supreme court’s majority opinion began by reformulating the question asked and stating the question it would answer as follows:

To what extent does the business judgment rule as recognized in Minnesota law require a court, in deciding whether to approve a proposed settlement of a shareholder derivative action, to defer to the decision of a Special Litigation Committee duly constituted under Minn. Stat. § 302A.241, subd. 1 (2006), that the derivative action should be settled on specific terms?¹⁷⁴

The supreme court answered that judicial review was to be limited to the issues of independence and good faith and that the business judgment rule precluded judicial review of the substance of the SLC decision.¹⁷⁵ Thus, the answer to Judge Rosenbaum’s question was “no,” the court could not examine the reasonableness of the SLC’s decision or reject it on the merits, unless the court’s review addressed, and was confined to, the two factors of independence and good faith.¹⁷⁶ Justice Paul Anderson’s concurring opinion would have found a basis for the court to review the rationality of the SLC report.¹⁷⁷

Plaintiffs had argued that Federal Rule of Civil Procedure 23.1(c) trumped the applicability of the Minnesota business judgment rule to the SLC report because it required that the derivative suits could be “settled, voluntarily dismissed, or compromised *only* with the court’s approval.”¹⁷⁸ The supreme court held that the comparable Minnesota rule was procedural and not substantive, and therefore not applicable to Judge Rosenbaum’s decision.¹⁷⁹ The Court left the federal rule for Judge

173. *In re UnitedHealth Group Inc. S’holder Derivative Litig.*, 754 N.W.2d 544, 549 (Minn. 2008) (quoting *In re UnitedHealth*, 2007 WL 4571127, at *8).

174. *Id.* at 549.

175. *Id.* at 561.

176. *Id.*

177. *See infra* Part IV.D.

178. *In re UnitedHealth*, 754 N.W.2d at 552 (emphasis added) (quoting FED. R. Civ. P. 23.1(c)).

179. *Id.* UHG was a Minnesota corporation; hence, the Federal District Court of Minnesota needed to apply the substantive law of Minnesota. *See* *Erie R.R. Co. v. Tompkins*, 304 U.S. 64 (1938) (requiring federal courts handling diversity cases

Rosenbaum to interpret and apply if appropriate.¹⁸⁰ In later granting approval to the SLC report, Judge Rosenbaum did not invoke the federal rule.¹⁸¹

To answer the certified question as reformulated, the Minnesota Supreme Court defined a standard of review for SLC reports and decisions. The court chose to adopt and follow the *Auerbach* (New York) line of authority rather than the *Zapata* (Delaware) line.¹⁸² In following *Auerbach*, the court concluded it “should defer to an SLC’s decision to settle a shareholder derivative action if (1) the members of the SLC possessed a disinterested independence and (2) the SLC’s investigative procedures and methodologies were adequate, appropriate, and pursued in good faith.”¹⁸³

The court apparently intended to separate one issue, as to whether findings and reasons were required, from the other issue of whether the SLC used appropriate “investigative procedures and methodologies.”¹⁸⁴ To justify excluding inquiry beyond the procedures and methodologies, the court argued that “findings and reasons” were part of the substantive action of the SLC and thus not subject to judicial requirement or review.¹⁸⁵ The court’s analysis, from statutes to public policy, set out its rationale for adopting the *Auerbach* approach.

1. *The Court’s Quest for Statutory Guidance*

The court observed that “section 302A.241, subd. 1, does not addresses [sic] the deference to be afforded an SLC’s decision to settle a derivative action . . .” but does however mandate independence on part of the SLC.¹⁸⁶ The court then looked to the fiduciary duties of directors as provided in Minnesota statutes:

to look to the substantive law of the state in which the federal court was located).

180. *In re UnitedHealth*, 754 N.W.2d at 552.

181. *See In re UnitedHealth Group, Inc. S’holder Derivative Litig.*, 631 F. Supp. 2d 1151 (D. Minn. 2009).

182. *In re UnitedHealth*, 754 N.W.2d at 556.

183. *Id.* at 559. Adding to this standard, the court re-affirmed the *Janssen* rule and stated that “if the initial SLC investigation and recommendation fail to satisfy this standard, ‘the derivative suit proceeds on its merits’ with no opportunity to rectify any deficiencies.” *Id.* (quoting *Janssen v. Best & Flanagan*, 662 N.W.2d 876, 889 (Minn. 2003)).

184. *Id.*

185. *Id.* (quotations added).

186. *Id.* at 553.

A director shall discharge the duties of the position of director in good faith, in a manner the director reasonably believes to be in the best interests of the corporation, and with the care an ordinarily prudent person in a like position would exercise under similar circumstances. A person who so performs those duties is not liable by reason of being or having been a director of the corporation.¹⁸⁷

The court acknowledged the good faith requirement as set out above but did not apply the “reasonably believes” wording to the decision of an SLC duly appointed under Minnesota Statutes section 302A.241.¹⁸⁸ The court’s failure to apply this reasonableness clause motivated Justice Paul Anderson’s departure in his concurring opinion.¹⁸⁹ In his view, an SLC decision should be subject to a rationality standard in addition to the disinterested independence and good faith standards of *Auerbach*.¹⁹⁰

2. Seeking Help from Case Law

Since neither section 302A.241 nor section 302A.251 expressly directs courts to look beyond good faith and independence,¹⁹¹ the court looked to its past opinion in *Janssen v. Best & Flanagan*.¹⁹² That decision however, gave no clear guidance on the issue of scope of review because the *Janssen* court neither accepted nor rejected the business judgment rule as applicable to an SLC’s decision.¹⁹³ In *Janssen*, the issue rather turned on the court’s finding that the SLC was in fact not independent.¹⁹⁴

Without controlling precedent or statutory guidance, the court compared *Auerbach* and *Zapata* on a policy analysis.¹⁹⁵ The court

187. MINN. STAT. § 302A.251, subdiv. 1 (2008).

188. *In re UnitedHealth*, 754 N.W.2d at 553, 559–60.

189. *See infra* Part IV.D.

190. *See infra* Part IV.D.

191. *See* MINN. STAT. §§ 302A.241, 302A.251 (2006).

192. *In re UnitedHealth*, 754 N.W.2d at 551 (referring to *Janssen v. Best & Flanagan*, 662 N.W.2d 876, 882 (Minn. 2003)).

193. *Id.* at 554. *Janssen* established the minimum requirements of good faith and independence; however, the decision “explicitly declined to ‘adopt a particular version of the business judgment rule’” and rather assumed that the *Auerbach* standard would still apply. *In re UnitedHealth, Inc. S’holder Derivative Litig.*, Nos. 06-CV-1216, 06-CV-1691, 2007 WL 4571127, at *7 (D. Minn. Dec. 26, 2007) (quoting and referring to *Janssen*, 662 N.W.2d at 888 n.5).

194. *In re UnitedHealth*, 754 N.W.2d at 554 (citing *Janssen*, 662 N.W.2d at 888).

195. *See id.* at 554–55.

adopted the *Auerbach* standard for the same reasons emphasized in the *Auerbach* decision.¹⁹⁶ However, the supreme court *added* its own policy justifications: (1) corporate interests do not always mandate litigation, even when harm has been caused by one of the directors;¹⁹⁷ (2) strike suits¹⁹⁸ would increase if courts could inquire into the substantive reasonableness of SLC decisions;¹⁹⁹ (3) the possibility of judicial bias is potentially greater than that of directors;²⁰⁰ and (4) courts should not replace business judgments in the name of public policy because courts do not have to deal with the long term economic consequences of a full litigation proceeding.²⁰¹

The court believed that SLCs are trustworthy since “it seem[s] unlikely that a member of an SLC will reach a decision that could harm the company merely because he or she feels some empathy for the individuals under investigation.”²⁰² The court justified this statement with three general assertions: (1) SLCs were composed of individuals who spent their careers building business reputations; (2) since the SLC members in the *UnitedHealth* case were former members of the judiciary, the risk of improper influence was insignificant; and (3) derivative suits are not at risk of being completely undermined by the court’s adoption of the *Auerbach* standard.²⁰³

D. Justice Anderson’s Concurrence: The Idea of a Rationality Standard

Justice Paul Anderson concurred with the majority in its decision to uphold the settlement, yet he believed the standard of

196. *See id.* at 556–57.

197. *Id.* at 557.

198. Strike suits are defined as “suit[s] . . . often based on no valid claim, brought either for nuisance value or as leverage to obtain a favorable or inflated settlement.” *Id.* at 550 n.4 (quoting BLACK’S LAW DICTIONARY 1475 (8th ed. 2004)).

199. *Id.* at 557.

200. This reasoning was based on the theory by Stephen M. Bainbridge, which asserted that market competition between firms creates incentive to “even the most self-interested directors” to act in the best interest of their corporations. *Id.* at 558. Courts to the contrary have no market forces encouraging them to make sensible business judgments. *Id.* at 557–58 (referring to Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 122 (2004)).

201. *Id.* at 557. The court also noted that the burden of proof was on the corporation to establish compliance with the standards. *Id.* at 561.

202. *Id.* at 558.

203. *Id.* The court finalized the rationale for its rule with the specific circumstances of the case—namely, that the suit was settled. *Id.* at 559.

review needed a rationality requirement.²⁰⁴ He argued that the court's standard gives excessive deference to SLC recommendations because it fails to address decisions that are "on their face, wholly irrational."²⁰⁵ Such a result, he argued, conflicts with the language of section 302A.251, which requires a director who seeks protection of the business judgment rule to act "in a manner [he or she] reasonably believes to be in the best interests of the corporation, and with the care an ordinarily prudent person in a like position would exercise under similar circumstances."²⁰⁶

Justice Anderson argued the good faith standard was insufficient to deter irrational decisions by SLCs because good faith requires belief that one's actions best serve the interests of the corporation, whereas rationality requires that such a belief be reasonable.²⁰⁷ In other words, he argued that a director may have good intentions for the corporation and yet make a decision that is so irrational it violates Minnesota Statutes section 302A.251.²⁰⁸

Justice Anderson proposed a "middle-ground" approach which retains the requirements set forth in the court's opinion only with the additional requirement that the SLC's recommendation be shown to serve some "rational business purpose."²⁰⁹ Unlike the standard in *Zapata*, a reasonableness standard would not allow the autonomy and authority of the directors (respect for the business judgment rule) to be encroached upon by the courts because it still prohibits the courts from second-guessing SLC decisions by mere disagreement over which corporate interests deserve the greatest consideration.²¹⁰ He argued that the risk of any potential overstepping would be diminished by the low probability that an independent investigation, conducted in good faith, would lead a sophisticated group of members to reach a senseless conclusion.²¹¹

V. ANALYSIS OF THE *UNITEDHEALTH* DECISION

The *UnitedHealth* decision precludes courts from reviewing the substance behind an SLC's decision to dismiss a derivative suit so

204. See *id.* at 561–62 (Anderson, J., concurring).

205. *Id.* at 562.

206. *Id.* at 563 (citing MINN. STAT. § 302A.251, subdiv. 1 (2006)).

207. *Id.* (referring to the definition of good faith, which is stated in MINN. STAT. § 302A.011, subdiv. 13 (2006)).

208. See *id.*

209. *Id.* at 564–65.

210. See *id.* at 565.

211. See *id.* at 565–66.

long as the SLC is found to be independent, applies appropriate procedures in the investigation, and acts in good faith.²¹² SLCs do not have to specify *why* the derivative suits should be dismissed.²¹³ Therein lies the central problem: confining judicial review to the SLC's procedures and independence will not protect corporations when SLCs make irrational decisions or fail to document their decisions with findings of fact and well reasoned conclusions.

Up front, the majority's notion—that substantive review contradicts the business judgment rule—misstates the business judgment rule's true meaning. Even directors who are disinterested must not *wrongfully* refuse to sue.²¹⁴ Wrongful demand is characterized by the failure of directors to act “in an *informed manner* and with due care, in a good faith belief that their action was in the best interest of the corporation.”²¹⁵ This version of the business judgment rule is not confined to Delaware cases; Minnesota also holds directors to this standard when demand is made by the shareholders.²¹⁶

The *UnitedHealth* majority nevertheless refused to hold SLCs to the same expectation even though the SLC members were making the same decision the directors would have made had they been disinterested.²¹⁷ Consequently, SLCs can dismiss derivative suits *wrongfully* without repercussions because the *Auerbach* standard merely ensures the SLC will assert that they followed appropriate procedures.²¹⁸ Beyond that, they can make their decisions for

212. See *id.* at 555 (majority opinion). The court admits that “some judicial analysis of the manner in which a decisionmaker gathers the factual data underlying a decision” is acceptable under Minnesota Statutes section 302A.251, subdivision 2 (2006). *Id.* at 559. Also, while the decision pertained to a proposed settlement, the court clarified that the standard should apply to all SLC decisions, regardless of their specific recommendations. See *id.* (stating that “the dismissal of meritorious litigation may be justifiable, such as when pursuit of the claim will prove more costly than beneficial.”).

213. See *id.*

214. See *supra* note 62.

215. 2 BLOCK ET AL., *supra* note 33, at 1615 (quoting *Levine v. Smith*, 591 A.2d 194, 197–98, 210 (Del. 1991) (quoting *Aronson v. Lewis*, 473 A.2d 805, 808 (Del. 1984))).

216. *In re UnitedHealth*, 754 N.W.2d at 551 (noting that a business director is protected “[u]nder the business judgment rule, so long as a disinterested director makes ‘an informed business decision’”) (quoting *Janssen v. Best & Flanagan*, 662 N.W.2d 876, 882 (Minn. 2003)).

217. *Id.* at 564 (Anderson, J., concurring).

218. Julian Velasco, *Structural Bias and the Need for Substantive Review*, 82 WASH. U. L.Q. 821, 872 (2004) (“If substance is beyond review, any amount of process can be overcome to reach the desired result: the decision maker need only hear

reasons unrelated to their factual findings, or worse, they can reach their decisions without making any factual findings. Without some level of review, courts have no way of testing the appropriateness or adequacy of the processes used or the true disinterestedness of the members.

The court may have been unwise to adopt the *Auerbach* standard. Instead, the court should have adopted the *Zapata* standard because (1) it is more consistent with Minnesota statutes; (2) it addresses problems associated with tainted boards selecting their own SLC committees; and (3) it provides a basis for cross-checking on true disinterestedness and appropriate process. As has been pointed out above, the court may have been overly influenced by the personal make-up of the UHG SLC and may not have focused on the fact that the standards enunciated would apply equally to a small company (where temptations could be much more serious) as to a large public company.²¹⁹

A. Statutory Support for a More Enhanced Review

As earlier stated, the Minnesota statute requires a director to make decisions “in a manner the director *reasonably* believes to be in the best interests of the corporation, and *with the care an ordinarily prudent person in a like position would exercise under similar circumstances.*”²²⁰ The court stated that the choice of whether to sue or not is a business decision belonging to the corporation.²²¹ It follows that even decisions to sue must be made *reasonably* to enjoy business judgment rule protection.²²² Strangely, the *UnitedHealth* court concluded differently.

Subdivision seven of section 302A.241 states that SLC members “are deemed to be directors for purposes of section[] 302A.251.”²²³ By cherry picking only some requirements from this section, the court gave short shrift to section 302A.241, which states that *all* requirements under section 302A.251 pertain to committee members,²²⁴ including SLCs.²²⁵ True, the statute does not expressly

the evidence before rejecting it.”).

219. Their credentials are strongly established. See SLC Report, *supra* note 9, ¶ I.D.

220. MINN. STAT. § 302A.251, subdiv. 1 (2008) (emphasis added).

221. *In re UnitedHealth*, 754 N.W.2d at 550.

222. See § 302A.251, subdiv. 1; see also *supra* note 27.

223. MINN. STAT. § 302A.241, subdiv. 7 (2008).

224. See *id.* (stating committee members are “directors” for purposes of section 302A.251).

require SLCs to make reasonable decisions.²²⁶ Fundamentally, however, the plain meaning stems from the context of the statute as a whole, not solely the technical choice of words in a single provision.²²⁷

Overall, the Minnesota statutes require courts to review the reasonableness of SLC decisions just as they should review decisions of other committees or decisions of the board itself.²²⁸ It seems unlikely that the legislature would wish SLCs to *substitute* their own personal preferences and opinions for the minimum standards of reasonable decision-making because section 302A.241, subdivision 6 articulates that neither the establishing of a committee nor acting as the committee relieves directors of liability from the duty of care in section 302A.251, subdivision 1.²²⁹

Corporations favor the use of SLCs when corporate directors, by reason of conflicts of interest, may not be trusted to serve the corporation's best interests.²³⁰ Given the SLC's purpose and function, its decision should reasonably serve these interests in the same way a corporate director, if not conflicted, would serve them.²³¹ Because the *UnitedHealth* standard prevents courts from

225. See § 302A.241, subdiv. 1 ("Committees may include a special litigation committee . . .").

226. See § 302A.251, subdiv. 1. *But cf. In re UnitedHealth*, 754 N.W.2d at 559 (applying section 302A.251, subdivision 1 to SLCs to support its holding that SLCs be independent and act in good faith). The majority in *UnitedHealth* relied on an article that asserted the difference between the business judgment rule and the business judgment doctrine; the former pertains to the protection of directors who make reasonable business decisions and the latter protects the decisions themselves. *Id.* at 551 n.6 (citing Joseph Hinsey IV, *Business Judgment and the American Law Institute's Corporate Governance Project: The Rule, the Doctrine, and the Reality*, 52 GEO. WASH. L. REV. 609, 611–12 (1984)). Nonetheless, the article notes that "the essential elements of the doctrine and the rule are the same." Hinsey, *supra* at 612. Later in its opinion, the *UnitedHealth* court renames its application of the business judgment rule as the "business judgment liability rule" for the sake of distinguishing it from section 302A.251, subdivision 1 and excluding the reasonableness requirement. See *In re UnitedHealth*, 754 N.W.2d at 553 n.8.

227. See MINN. STAT. § 645.16 (2004); *Mavco, Inc. v. Eggink*, 739 N.W.2d 148, 153 (Minn. 2007).

228. See MINN. STAT. § 302A.241, subdiv. 7 (2008) (stating committee members are deemed directors for purposes of section 302A.251); MINN. STAT. § 302A.251, subdiv. 1 (2008) (requiring directors to act reasonably).

229. See § 302A.241, subdiv. 6.

230. See Charles W. Murdock, *Corporate Governance, the Role of Special Litigation Committees*, 68 WASH. L. REV. 79, 84–87 (1993).

231. Section 302A.241 likewise imposes the same requirements on committees regarding the procedures as those that are imposed on corporate directors. See § 302A.241, subdiv. 4.

assessing the reasoning behind SLC conclusions, section 302A.251 is significantly deprived of its intended effect.²³²

B. Structural Bias and the Problems with Tainted Boards Selecting the SLCs

When demand is excused, courts may not trust defendant directors; yet, to manage the resulting lawsuit impartially, Minnesota statutes permit the same group of directors to appoint individuals who will handle the same task.²³³ Such is the situation even when corporate directors face serious claims of self-dealing.²³⁴ By networking, directors can potentially “shop” for SLC members whom they believe will decide the outcome in their favor.

Historically, SLCs have nearly always settled or dismissed derivative suits.²³⁵ This trend is consistent with the potential for *structural bias* in the selection of SLC members. “Structural bias” has been described as occurring when “the judgment of seemingly disinterested directors—who are not defendants in a litigation or participants in a wrongdoing alleged in a litigation—is inherently corrupted by the ‘common cultural bond’ and ‘natural empathy and collegiality’ shared by most directors.”²³⁶

The *UnitedHealth* majority noted that the federal district court would decide whether the SLC was independent, yet suggested that appropriate factors to consider in making this decision included (1) any possible interest the SLC members might have in the litigation;²³⁷ (2) their affiliations through prior business dealings or

232. See *infra* Part VI.

233. MINN. STAT. § 302A.241, subdiv. 1.

234. See *Black v. NuAire, Inc.*, 426 N.W.2d 203, 210–11 (Minn. Ct. App. 1988) (stating that directors have a “fundamental responsibility and authority for corporate management”).

235. See *id.* at 210 (recognizing the inherent risk that committee members will always be hesitant to recommend litigation); Douglas M. Branson, *The Rule that Isn't a Rule—the Business Judgment Rule*, 36 VAL. U. L. REV. 631, 641–42 (2002). See also George W. Dent, Jr., *The Power of Directors to Terminate Shareholder Litigation: The Death of the Derivative Suit?*, 75 NW. U. L. REV. 96, 105–09 (1980) (arguing that the use of special litigation committees may effectively prevent derivative suits in most cases).

236. 2 BLOCK ET AL., *supra* note 33, at 1765 (citing James D. Cox, *Searching for the Corporation's Voice in Derivative Suit Litigation: A Critique of Zapata and the ALI Project*, 1982 DUKE L.J. 959, 962, 1008 (1982)).

237. This includes:

(1) whether the members are defendants in the litigation; (2) whether the members are exposed to direct and substantial liability; (3) whether the “members are outside, non-management directors”; (4) whether the

relationships; (3) whether the SLC members received advice from counsel or “other independent advisors”; (4) the severity of the alleged conduct; and (5) the size of the SLC.²³⁸

In response to the concerns over structural bias, the *UnitedHealth* majority argued that SLC members are discouraged from making biased decisions because SLC members empathize with the well being of the corporation;²³⁹ their concern for their own reputation overrides any urge to make unreasonable decisions for the sake of the directors;²⁴⁰ and they are far enough outside the corporate ranks for any empathy they might have for the directors to actually affect their decisions.²⁴¹

But whether this test truly ensures independence may depend on how structural bias can affect SLC decision making. Thus, before analyzing the independence test in *UnitedHealth*, the reader should understand the two pertinent psychological aspects of structural bias: in-group association and cultural similarity.

1. *In-Group Bias*

James Cox and Harry Munsinger published an article on structural bias,²⁴² in which they examined the Robbers’ Cave experiment.²⁴³ This study involved two groups of young men at a summer camp.²⁴⁴ The experimenters assigned each group different camping tasks.²⁴⁵ After the tasks were completed, the experimenters held competitions between these two groups and

members were on the board when the alleged wrongdoing occurred; [and] (5) whether the “members participated in the alleged wrongdoing[.]”

In re UnitedHealth Group, Inc. S’holder Derivative Litig., 754 N.W.2d 544, 560 n.11 (Minn. 2008) (quoting 2 BLOCK ET AL., *supra* note 33, at 1746–53).

238. *Id.*

239. *Id.* at 558.

240. *Id.*

241. *Id.* Notably, the members comprising the SLC in *UnitedHealth* were former members of the Minnesota Supreme Court. *Id.* at 548. Even if this were to make one feel a greater sense of trust in the SLC’s recommendation, not all SLCs have former justices since Minnesota statutes do not require SLC members to have judicial experience. See MINN. STAT. § 302A.241, subdiv. 2 (2008) (requiring only that committee members be “natural persons”).

242. James D. Cox & Harry L. Munsinger, *Bias in the Boardroom: Psychological Foundations and Legal Implications of Corporate Cohesion*, 48 LAW & CONTEMP. PROBS. 83 (1985).

243. *Id.* at 100–01.

244. *Id.* at 100.

245. *Id.*

discovered, as a result of their in-group chemistry, both groups became increasingly hostile towards one another.²⁴⁶ They later merged the two groups and assigned tasks that required cooperative efforts.²⁴⁷ As a result both groups then interacted more positively.²⁴⁸ Despite popular assumptions, the competitions did *not* primarily cause hostility.²⁴⁹ Shortly after the experimenters separated the groups, and prior to the competitions, both groups jeered at one another, signifying that the separate grouping created negative tension between both groups.²⁵⁰

Although camping activities and corporate governance constitute significantly different activities, they can induce the same psychological force: in-group bias.²⁵¹ The age difference between the campers and corporate directors doesn't change this; Cox and Munsinger referred to another study where experimenters gave two groups options to distribute monetary rewards and penalties to in-group members, members from the other group, or both.²⁵² Each group not only preferred awarding benefits to in-group members, they "[maximized] *the difference between their own group and the other group, even though that strategy caused them to forsake a profit maximizing option for their ingroup.*"²⁵³

In-group bias occurs because people value the sense of belonging.²⁵⁴ Likewise, SLC members value being selected to handle derivative suits.²⁵⁵ Because they were selected by directors, they may associate this value with the directors.²⁵⁶ Consequently, they and the directors may become one group, separating derivative or class action plaintiffs into an outside group.²⁵⁷ Given

246. *Id.*

247. *Id.*

248. *Id.*

249. *Id.*

250. *Id.*

251. *Id.*

252. *Id.* at 101.

253. *Id.* (second emphasis added).

254. "[I]ndividuals associate and maintain their membership in groups that make a positive contribution toward their social identity, from which they derive emotional or value significance. A further benefit derived from membership in a group is its contributions to the members' sense of self-worth." *Id.* at 102.

255. "As seen earlier, individuals place great value on their selection to and membership on a corporation's board: They are attracted to their colleagues and value greatly the associations they reap from the directorship." *Id.* at 104 (referring specifically to SLC members in the context of derivative suits).

256. *Id.*

257. *Id.*

this rivalry, the reader may guess why SLCs persistently recommend dismissal of derivative suits.

2. *Cultural Bias*

While most SLCs do not *purposefully* favor the directors' interests to the corporation's detriment, their association with the board causes them to agree with the directors, even in good faith, over which action best serves the corporation's interests.²⁵⁸ However, in-group bias alone does not cause this trend. Friendships between directors grow during their tenures and thus become the source of income and prestige many directors need.²⁵⁹ SLC members who are selected tend to be individuals with whom the board has shared experiences, whether through business transactions, business backgrounds, social gatherings, or common acquaintances.²⁶⁰ Due to these circumstances, the duty of making a judgment regarding the board members tends to exacerbate the in-group favoritism.²⁶¹ As a result, the SLC members and defendants may develop a common perspective vis-à-vis plaintiffs, which then causes SLCs to favor the defendants despite possible contrary indications.²⁶²

The *UnitedHealth* court recognized friendships as one of several considerations to use in determining an SLC's independence, but this standard is often too intangible to apply.²⁶³ From a policy standpoint, precluding SLC independence on the grounds of close friendships would render SLCs useless because most corporate executives have already been acquainted with individuals from similar backgrounds.²⁶⁴ Moreover, cultural bias does not depend on established friendships to affect an SLC

258. See *supra* Part V.B.

259. See Cox & Munsinger, *supra* note 242, at 104.

260. *Id.* at 107.

261. *Id.*

262. Julian Velasco, *Structural Bias and the Need for Substantive Review*, 82 WASH. U. L.Q. 821, 859 n.158 (2004) (citing a number of reports on the effects friendships have on the investigatory process, including Donald C. Langevoort, *Monitoring: The Behavioral Economics of Corporate Compliance with Law*, 2002 COLUM. BUS. L. REV. 71, 86 (2002); Linda R. Meyer, *Forgiveness and Public Trust*, 27 FORDHAM URB. L.J. 1515, 1537 (2000)).

263. Velasco, *supra* note 262, at 843.

264. See Velasco, *supra* note 262, at 859 (quoting *Beam v. Stewart*, 845 A.2d 1040, 1051–52 (Del. 2004) (asserting that prior business acquaintances coupled with the attendance of multiple social events was not enough to “rebut the presumption of independence.”)).

member's perspective; the sharing of a common background increases mutual attraction and consequently ethnocentrism.²⁶⁵ The cultural bonds, sense of association, and complexity of shared tasks exert extra psychological force when occurring together within an SLC member.²⁶⁶

3. *The UnitedHealth Standard Underestimates Structural Bias*

As shown earlier, structural bias can impact decision making to a significant degree, which explains the likely reasons for an SLC's common tendency to dismiss a derivative suit. While the *UnitedHealth* factors provide a detailed disclosure of an SLC member's history with the company, structural bias cannot be remedied by background checks.²⁶⁷ In-group bias and cultural bias can exist without prior business dealings, material interests in the suit, or interactions with board members because they stem from the selection process.²⁶⁸ These biases exist in groups of all sizes and impact decision making regardless of the severity of the alleged conduct.²⁶⁹ Of course, the *UnitedHealth* factors remain important for consideration, but do not, by themselves, establish that SLCs are truly independent.

The court's generalizations about the SLC's incentives to resist their personal biases may overlook two realities behind the SLC's decision making process. First, an SLC member's empathy for a corporation is no stronger than that of the director, yet the latter has never discouraged directors from committing misconduct.²⁷⁰

265. Cox & Munsinger, *supra* note 242, at 105.

266. See *id.* at 104 ("This synergism creates compelling psychological forces toward ingroup biases within the . . . special litigation committee.").

267. But even then, establishing these factors typically does not disqualify the board. If some factors are shown to exist, as long as an SLC member did not participate in the alleged misconduct, courts are commonly hesitant to question the independence of the SLC. See 2 BLOCK ET AL., *supra* note 33, at 1755. One court even acknowledged that "[b]usiness dealings seldom take place between complete strangers and it would be a strained and artificial rule which required a director to be unacquainted or uninvolved with fellow directors in order to be regarded as independent." *Id.* (quoting *In re Oracle Sec. Litig.*, 852 F. Supp. 1437, 1442 (N.D. Cal 1993)).

268. See Cox & Munsinger, *supra* note 242, at 104.

269. See *id.*

270. Dr. McGuire is our case in point. Prior to the backdating scheme, he served UHG as its director for seventeen years, fifteen of which he spent as the chair. See SLC Report, *supra* note 9, at 7. He was furthermore accredited for helping "the Company's revenues [grow] from approximately \$600 million to more than \$70 billion, with an average annual return to shareholders of nearly 30

Second, SLC members are not as distant from the corporate ranks as the majority presumes. As shown above, from the moment they are selected, SLC members may feel a sense of association, which can seriously impact their decisions.²⁷¹ Because the *UnitedHealth* standard precludes courts from reviewing the findings and reasons behind the SLC's recommendations, the reasoning and motives of these committee members may not be disclosed, not even in cases where the facts could materially contradict the rationale behind their recommendations.

On the other hand, the *Zapata* standard provides an opportunity—not a requirement—for thorough judicial review. Under this standard, the court can examine findings, reasoning and conclusions, and thus, verify the true independence of the SLC members in the processes they used and applied.²⁷² Surely, a plaintiff who established that the complaint was well-pleaded or that the lawsuit should be certified as a class action should be entitled to no less.

C. Difficulties in Confirming Good Faith and Adequacy

The problem resulting from structural bias is worsened by the fact that the standard adopted by the court prevents judges from testing the “honesty” of the SLC's investigation. None can refute the principle that the final conclusions of an SLC should be based on the facts. Good faith, after all, means “honesty in fact.”²⁷³ The SLC's duty to make well-informed decisions means that its decision should be based on findings.²⁷⁴ By issuing their report, the SLC members represent to the court that they base their recommendations on what they discovered in the investigation.²⁷⁵

percent.” *Id.*

271. See *supra* notes 254–255 and accompanying text.

272. There have been cases where SLC members' independence was refuted by the substance of their findings. See, e.g., *Maier v. Zapata Corp.*, 490 F. Supp. 348, 350–51, 354 (S.D. Tex. 1980), *aff'd*, 714 F.2d 436 (5th Cir. 1983). The court found that regardless of whether the SLC conducted a procedurally adequate investigation, their conclusions and recommendations were not reasonably supported by the facts. *Id.* at 354.

273. MINN. STAT. § 302A.011, subdiv. 13 (2006).

274. See *In re UnitedHealth, Inc. S'holder Derivative Litig.*, 754 N.W.2d 544, 551 (Minn. 2008).

275. In every conclusion, the UHG SLC begins by saying “[i]n light of the many factors it considered . . .” and “[i]n light of these considerations . . .” and “critical to its consideration was the lack of evidence supporting the pursuit of these claims . . .” See SLC Report, *supra* note 9, ¶ IV.A–F. These are all assertions

Yet, the *Auerbach* standard contains no mechanism for verifying, if necessary, that this representation is true.²⁷⁶

Thus, in the UHG SLC report, the SLC members listed the pertinent laws and thoroughly explained their procedures.²⁷⁷ However, as Judge Rosenbaum pointed out, they did not provide factual findings and analysis in a manner that would explain and justify their recommendations.²⁷⁸ Omitting substantive support does not demonstrate *bad faith*, yet, it inhibits the court from ensuring the SLC investigated and managed the derivative suit in *good faith*.

The *Zapata* standard fixes this problem. Delaware requires plaintiffs who challenge the independence of SLCs to show that the committee members “based [their] conclusions . . . on . . . outside influences rather than the merits of the issues.”²⁷⁹ Upon a proper showing, the court reviews the substance of the SLC findings to determine whether the SLC conducted its investigation without any extraneous influence.²⁸⁰ Requiring substantive support for their conclusions and recommendations ensures that SLC directors actually base their decisions on the merits of the case.

VI. DEBATABLE CRITICISM: A BETTER UNDERSTANDING OF THE ZAPATA STANDARD

The *UnitedHealth* court rejected the *Zapata* standard for seven reasons,²⁸¹ but none of these policy justifications obviate the need to scrutinize SLC decisions to the extent discretionally permitted by *Zapata*.

to the court that the SLC based its recommendations on the facts discovered from the investigation. *See id.*

276. The question of adequacy “is *solely* how appropriately to set about to gather the pertinent data.” *Auerbach v. Bennett*, 47 N.Y.2d 619, 634 (1979) (emphasis added). The court went on to say that “[w]hat has been uncovered and the relative weight accorded in evaluating and balancing the several factors and considerations are beyond the scope of judicial concern.” *Id.*

277. *See* SLC Report, *supra* note 9, ¶ II–III.

278. *Id.* Without providing any factual support, they based their recommendations on conclusions that only “some of the claims against Dr. McGuire may have merit” or that some defenses “might be available to him.” *Id.* at 59.

279. 2 BLOCK ET AL., *supra* note 33, at 1755 (quoting *Kaplan v. Wyatt*, 499 A.2d 1184, 1190 (Del. 1985)).

280. *Id.*

281. *See In re UnitedHealth, Inc. S’holder Derivative Litig.*, 754 N.W.2d 544, 556–58 (Minn. 2008).

The court's first argument, that judges are unqualified²⁸² to evaluate business judgments, departs from established business-judgment-rule law and undervalues the fact that an SLC report is (or should be) a combination of a recital of processes used, findings made, and reasoned conclusions.²⁸³ The court's second concern emphasized the complexity of second-guessing SLC decisions; however, judicial review does not have to involve investigation or second-guessing of the *business judgment* exercised by the SLC.²⁸⁴ What should be reviewed is the process used and an assurance that it was not tainted by arbitrary behavior. The fact remains that in most derivative cases, shareholders accuse directors of disloyalty. Judges undisputedly are the experts in this issue because it stems from the *legal* nature of one's conduct, not from complex balancing of business interests.²⁸⁵

The court's third argument—that SLC directors need to be able to prevent litigation when they believe it would do more harm than good²⁸⁶—is true, but arguably not to the point. Nowhere in the Delaware Supreme Court's opinion did the *Zapata* majority suggest that courts must review all derivative suits.²⁸⁷ If the SLC genuinely finds the claims to be meritless or the litigation costs to be prohibitive, it can easily persuade judges with its substantive findings of fact and reasoning. *Zapata* even stressed that a court “must *carefully consider* and weigh how compelling the *corporate interest* in dismissal is when faced with a non-frivolous lawsuit.”²⁸⁸ The *Zapata* standard encourages judges to consider corporate interests just as strongly as does the *Auerbach* approach.²⁸⁹ The *UnitedHealth* court's opinion may overlook the fact that the *Auerbach* standard can be especially troublesome in the context of suits affecting small corporations in that it undermines the opportunity of judicial review for arbitrary decision making.²⁹⁰

282. *Id.* at 556.

283. *Zapata Corp. v. Maldonado*, 430 A.2d 779, 788–89 (Del. 1980).

284. *See In re UnitedHealth*, 754 N.W.2d at 556, 566 n.8 (Anderson, J., concurring).

285. *Cf. Zapata Corp.*, 430 A.2d at 789 n.18 (stating that courts, not litigants, decide the merits of litigation).

286. *In re UnitedHealth*, 754 N.W.2d at 556–57.

287. *See Zapata Corp.*, 430 A.2d 779. Even in Delaware, SLC decisions to dismiss derivative suits are rarely overturned. *See also infra* note 293.

288. *Zapata Corp.*, 430 A.2d 779, 789 (Del. 1980) (emphasis added).

289. There have been no signs of widespread arbitrary disagreements leading courts to overturn SLC conclusions. *See infra* note 293 and accompanying text.

290. The ALI has suggested that because a small corporation is less separated

The *UnitedHealth* court's fourth and fifth reasons, that *Zapata* would waste judicial resources²⁹¹ and undermine the corporate autonomy needed to prevent strike suits,²⁹² simply presume that the *Zapata* standard creates an express lane for shareholders with meritless claims. Both arguments overlook the fact that Delaware courts rarely dismiss SLC decisions for lack of reasonable basis²⁹³ because the Delaware pleading standards require shareholders to allege the facts needed to justify a "reasonable doubt" that the SLC action is protected by the business judgment rule.²⁹⁴ More importantly, the shareholders must allege such facts "with particularity."²⁹⁵ This requirement means that courts will not overturn an SLC motion to dismiss a derivative suit every time the plaintiffs *generally* assert that the SLC's report or investigation was negligently or dishonestly conducted.²⁹⁶ Hence, they still grant SLC decision-making the very strong benefit of the doubt.²⁹⁷

The sixth concern for the *UnitedHealth* court was that, "[A] court applying its 'business judgment' is prone to act on its own biases and predilections. Ironically, then, *Zapata* simply replaces the danger of bias on the part of the corporate directors and the SLC with the danger of bias on the part of the court."²⁹⁸ This argument appears to discount or ignore the expertise of courts in reviewing fairness and adequacy of process in contexts where the courts have no specific background in or knowledge of the

from its shareholders, a compelled termination of a derivative suit by a separate committee would be less appropriate. See PRINCIPLES OF CORPORATE GOVERNANCE § 7.01 cmt. e, at 21 (1992). The policy reasons justifying derivative actions are "not always applicable to the closely held corporation." *Id.* Moreover, corporate boards are less likely to be disinterested in smaller firms because "the majority stockholders are likely also to be the firm's managers." *Id.*

291. See *In re UnitedHealth*, 754 N.W.2d at 557.

292. See *id.*

293. See, e.g., *Scattered Corp. v. Chicago Stock Exch., Inc.*, 701 A.2d 70, 75 (Del. 1997); *Kaplan v. Wyatt*, 499 A.2d 1184, 1192 (Del. 1985); *Carlton Invs. v. TLC Beatrice Int'l Holdings, Inc.*, 22 DEL. J. CORP. L. 1165, 1173 (1997).

294. 2 BLOCK ET AL., *supra* note 33, at 1614 (quoting *Levine v. Smith*, 591 A.2d 194, 210 (Del. 1991) (quoting *Aronson v. Lewis*, 473 A.2d 805, 808 (Del. 1984))).

295. 2 BLOCK ET AL., *supra* note 33, at 1614.

296. See *id.*; see also *Zapata Corp. v. Maldonado*, 430 A.2d 779, 788–89 (Del. 1981) (stating that if the SLC shows that its investigation was reasonable, independent, and in good faith, the court may dismiss the derivative suit on the derivative plaintiff's motion).

297. See *In re UnitedHealth Group Inc. S'holder Derivative Litig.*, 754 N.W.2d 544, 551 (Minn. 2008) (stating that a court will defer to the decision of an SLC where the board properly delegates its authority to act to the SLC).

298. *Id.* at 557.

particular subject matter involved. Under the Minnesota Rules of Evidence, for example, a court may require a medical expert to provide a factual basis underlying his or her ultimate opinions even though the court itself is not equally qualified in the field of medicine.²⁹⁹

Finally, the court characterizes *Zapata*'s allowance for judges to consider public policy as "troubling," in that it "compels a party to proceed with litigation because some *greater public good*, as determined by a court that will not have to live with the consequences of the decision, might result."³⁰⁰ Simply put, the *UnitedHealth* court assumes that *Zapata* will allow courts to prioritize public policy *over* corporate interests.³⁰¹ This assumption is overstated and perhaps takes the *Zapata* language out of context. The *Zapata* opinion stated that public policy "*when appropriate*" would be considered "*in addition* to the corporation's best interests," not *in place* of those interests.³⁰² In other words, the *Zapata* decision encourages courts to sometimes consider public policy factors, such as due process, but not to render decisions that serve the public *at the expense* of the corporation.³⁰³

All seven of the Court's policy arguments center on important considerations, yet none of them seem to deal adequately with balancing the risks of failing to detect arbitrary or worse actions by an SLC. The outstanding credentials and experience of the two SLC members involved in the *UnitedHealth* case may have distracted the Court's attention from the kinds of situations that, in the future, will be reviewed under the instructions of its opinion.

VII. CONCLUSION

UnitedHealth undoubtedly resulted in a sound decision and disposition of the litigation involved in that case. The credentials

299. See MINN. R. EVID. 703 (the facts which the expert relies upon must either be admissible or *reasonably* relied upon); see also MINN. R. EVID. 705 (the court may require an expert to disclose the facts underlying his or her conclusions).

300. *In re UnitedHealth*, 754 N.W.2d at 558 (emphasis added).

301. See *id.*

302. *Zapata Corp. v. Maldonado*, 430 A.2d 779, 789 (Del. 1981) (emphasis added).

303. Most importantly, the *Zapata* method of public policy considerations is supported by the Minnesota statutes, which provide that "[i]n discharging the duties of the position of director, a director may . . . consider . . . community and societal considerations . . ." MINN. STAT. § 302A.251, subdiv. 5 (2008).

and expertise of the SLC were impeccable.³⁰⁴ Judge Rosenbaum appears to have accepted that decision and applied it in granting approval to the settlement as arranged by the SLC.³⁰⁵ Whether, as Judge Rosenbaum questioned earlier, the former CEO should be permitted to retain (according to the Judge) “pelf” in the amount of \$800 million,³⁰⁶ and whether any responsibility of the former chair of the UHG Compensation Committee, who was apparently involved in at least part of the options issues,³⁰⁷ should be tied to an arbitration to determine the value a lawsuit against him might have, are interesting questions. It seems appropriate to respect the SLC determination that “enough was enough” and that reasonable justice had been or would be done.

If the reader takes two steps back from the decisions, however, several facts become clear. UHG paid \$895 million to settle the class action, with up to \$64 million in legal fees;³⁰⁸ UHG agreed to an SEC-imposed injunction (without admitting liability), prohibiting future violations of the federal securities laws in several specific ways;³⁰⁹ the SLC extracted additional recoveries of substantial value from the former CEO and the former general counsel, both of whom had been enjoined by the SEC from denying that they violated the federal securities laws;³¹⁰ and UHG was forced to restate its financials for a period of several prior years due to the overstatement of income and the understatement of expense associated with the options backdating.³¹¹

Do these facts raise a possible inference that the UHG board failed to exercise its oversight responsibilities in an adequate manner? Did any members of the board, other than the former CEO, the former Chairman of the Compensation Committee, and

304. The report provides irrefutable credentials of both former Minnesota Supreme Court Justices. See SLC Report, *supra* note 9, ¶ I.D.

305. See *In re UnitedHealth Group, Inc., S’holder Derivative Litig.*, 631 F. Supp. 2d 1151 (D. Minn. 2009).

306. *In re UnitedHealth Group, Inc., S’holder Derivative Litig.*, Nos. 06-CV-1216, 06-CV-1692, 2007 WL 4571127, at *6 (D. Minn. 2007).

307. He did resign following issuance of the Wilmer Cutler report. See Wilmer Cutler Report, *supra* note 140.

308. See STANFORD REPORT, *supra* note 3.

309. *Id.* (Under the terms of a proposed settlement agreement, UHG paid \$895 million into a settlement fund for the benefit of class members; UHG will also supplement the changes already implemented in its corporate governance policies.).

310. See SLC Report, *supra* note 9.

311. See *id.* at 31.

former General Counsel, face any repercussions? Were the monies paid out by UHG covered by insurance? If the value of the lawsuit against the former chair of the Compensation Committee had substantial value in the SLC-negotiated binding arbitration, were that person's legal costs, if any, covered by indemnification by UHG and thus by the shareholders? Did anyone on the board, other than the former CEO, suffer any financial consequences as a result of these "troubles"? Were members of the board responsible? Were they entitled to rely on representations and reports of the former CEO and other officials?

None of these questions appear to have been answered in any public forum—they have been disposed of by the SLC decision to dismiss all of the derivative cases³¹² and the presumptive acceptance of the settlement by the class action plaintiffs.³¹³ Given the decisions of the SLC, what can be said of the accountability, if any, of members of a board of directors? Has anyone asked whether it might be appropriate to seek recovery of director's fees and stock options from any director who shares responsibility for this fiasco?

UHG's option "troubles" are now apparently near an end. But the real significance of the *UnitedHealth* case will be found in the way in which it is applied to similar upcoming corporate situations. Here, the future is troubling.

The Minnesota Supreme Court has established that the corporation making use of an SLC to manage or dismiss derivative suits has the burden of proving (1) that the members appointed to serve on the SLC are disinterested, (2) that the procedures they used were reasonable and (3) that they acted in good faith.³¹⁴ As shown above, courts cannot effectively verify good faith or disinterestedness without first seeing how the procedures support an SLC's conclusions. Because neither findings of fact nor reasoned conclusions can now be required nor reviewed by a court, Minnesota courts, and federal courts exercising diversity jurisdiction where Minnesota law applies, are essentially restrained from verifying either disinterestedness or good faith.

These possible consequences of the *UnitedHealth* standard potentially reflect an impediment to holding directors accountable for their misconduct. Despite the exceptional credibility and

312. SLC Report, *supra* note 9.

313. See 10Q Report, *supra* note 13.

314. See *In re UnitedHealth Group, Inc., S'holder Derivative Litig.*, 754 N.W.2d 544, 559 (Minn. 2008).

credentials of the SLC members in *UnitedHealth*, we might see problems in the future in which SLC members, who possess substantially less credentials or credibility than the two incumbents in this case, can help directors avoid accountability by producing a report which proposes dismissal of pending lawsuits without showing any findings of fact or reasons for the decision.

In light of this situation, there are two possible ways in which the State could improve review of future SLC reports. The first is for new legislation to require courts to follow the Delaware *Zapata* standard in the future. After all, the *UnitedHealth* decision is no more than an interpretation of Minnesota Statutes sections 302A.251 and 302A.241.³¹⁵ The second is for courts to press for *detailed information* to support the corporation's burden of proof that the SLC in question "utilized appropriate investigative procedures and methodologies and pursued its investigation in good faith."³¹⁶ By enabling courts to verify *how* the SLCs' recommendations stem from proper procedures and methodologies, these implementations could ensure that director accountability is not dissipated by use of SLC investigations and reports.

315. MINN. STAT. §§ 302A.251, 302A.241 (2006).

316. *See id.* at 555.